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Politics this week

Nov 18th 2004
From The Economist print edition

Changing the guard

Reuters

Colin Powell resigned as America's secretary of state. **Condoleezza Rice**, currently the national security adviser and a closer ally of George Bush, was nominated as his replacement. Mr Powell's deputy, Richard Armitage, also stepped down. Stephen Hadley, formerly her deputy, replaces Ms Rice.

See article

There was also something of a clear-out of the rest of Mr Bush's **cabinet**: Ann Veneman, the agriculture secretary, resigned; Rod Paige departed as education secretary; and Spencer Abraham left the energy department.

Resignation fever also gripped the CIA. Several top officials quit, including the deputy director. Spook-watchers said that the leadership style of the new director, Porter Goss, was partly to blame.

See article

Worried by an investigation close to Tom DeLay, their majority leader, House Republicans changed a rule that would have forced any official to step down if indicted on **felony charges**. Republican senators discussed changing filibuster rules that could allow Democrats to block Mr Bush's judicial appointments.

Fallujah falls

After a week of intense fighting, American generals said that they had conquered the rebel **Iraqi** city of Fallujah for the loss of about 40 American and half a dozen Iraqi soldiers, with some 1,600 insurgents said to have been killed. It was unclear how many civilians had died, but most of the city's 300,000 people had left before the battle began. Leaders of the most radical Islamist groups appear to have escaped. Meanwhile, the insurgency reared up elsewhere, especially in Mosul, Iraq's largest northern city.

See article

Margaret Hassan, head of CARE International in Baghdad, who was British and Irish and married to an Iraqi, was shown on a video sent to the al-Jazeera satellite-TV channel being shot in the head, a month after being kidnapped by a group whose identity remains unknown.

In the wake of Yasser Arafat's death, the interim **Palestinian** leadership agreed to hold an election to choose a new president on January 9th. Mahmoud Abbas (also known as Abu Mazen) emerged as the likely candidate of Fatah, the biggest group within the Palestine Liberation Organisation, previously led by Mr Arafat.

See article

The Bush administration reacted warily to the news that **Iran** had agreed to a deal with the European trio of Britain, France and Germany to suspend efforts towards enriching uranium and producing plutonium. An Iranian exiled group accused Iran of buying the design for a bomb from the underground supply network run by Pakistan's former nuclear chief, Abdul Qadeer Khan, who sold weapon blueprints to—among others—Libya. America said Iran was working on ways to put nuclear warheads on missiles.

See article

The UN Security Council imposed an arms embargo on all sides fighting a civil war in **Côte d'Ivoire**. It said a travel ban and asset freeze would be imposed on a number of leading figures if they do not stop fighting and resume peace talks by December 15th.

The Security Council held a rare meeting of its 15 member countries outside New York. It convened in Kenya's capital, Nairobi, to encourage the implementation of a peace deal between **Sudan's** government and its once-rebellious south, while strife continued in the western province of Darfur.

Recommissioning Europe

The European Parliament approved the new **European Commission** presented by its president, José Manuel Barroso. Mr Barroso had been forced to withdraw his initial list, and to replace the Italian and Latvian nominees. The commission will now take office on November 22nd.

Eurostat, the EU's statistical office, confirmed that **Greece** had breached the euro area's budget-deficit ceiling of 3% of GDP every year between 1998 and 2003, including the years when it supposedly met the Maastricht criteria for entering the euro. The Greeks promised to improve, but went unpunished for their sins.

Ahead of a **Franco-British summit**, France's president, Jacques Chirac, and Britain's prime minister, Tony Blair, traded barbs over Europe's attitude to America. Mr Chirac said Mr Blair had gained nothing from supporting the Americans in Iraq; Mr Blair stressed the importance of a close transatlantic alliance.

In the first trial over the March 11th **train bombings in Madrid**, a 16-year-old youth pleaded guilty to helping to provide the explosives that were used. He was sentenced to six years in prison. Further trials are likely.

All-American affair

The 12th **Asia-Pacific Economic Co-operation** summit was due to begin in Chile on November 19th, and with it George Bush's first state visit since his re-election. Also present will be Hu Jintao, China's president, who in a swing through Argentina this week announced plans—albeit tentative—for $20 billion of investments there.

See article

A day after Donald Rumsfeld, America's defence secretary, warned Latin America that it too faces the threat of international terror, home-made bombs went off at three banks in **Buenos Aires**, causing one death. There have been several such bombings in Argentina since the peso's devaluation nearly three years ago.

Brazil's government said it would open the archives of the country's military dictatorship of 1964-85. The president, Luiz Inácio Lula da Silva, himself a prisoner during the dictatorship, has shown signs of wanting to make the army more accountable.

Chile became one of the last countries in the world to legalise divorce, as a law overturning the 1884 marriage code came into force.

Disputed territory

EPA

India's prime minister, Manmohan Singh, paid his first visit to **Kashmir** since taking office in May. Earlier, India had announced the withdrawal of an unspecified number of troops from the state, but Mr Singh ruled out any renegotiation of Kashmir's boundaries.

See article

UN figures showed that this year's was a bumper opium crop in **Afghanistan**. The area under poppy cultivation jumped by 64%, and only crop disease prevented this from being the largest opium harvest ever recorded.

See article

Pakistani security forces claimed to have knocked out several rebel outposts after clashes in the Afghanistan border area.

Japan's ruling Liberal Democratic Party started to consider constitutional changes that would let a woman ascend the imperial throne. The current crown prince, and his siblings, have no male children.

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Business this week

Nov 18th 2004
From The Economist print edition

Talking shop

Sears Roebuck, a department-store chain, and **Kmart**, one of the country's leading discount chains, agreed on a merger valued at some $11 billion to create America's third-largest retailer. Sears has made efforts to join the online-shopping age with the acquisition of Lands' End; Kmart has bounced back after emerging from bankruptcy in 2003. But the pair will remain a long way in size behind Wal-Mart, America's biggest retailer.

See article

Abercrombie & Fitch agreed to pay $40m to thousands of employees and jobseekers to settle a class-action law suit accusing the firm of favouring white workers. The upmarket casual-clothing company also agreed on measures to promote diversity, including the use of models from minority groups in ads and promotional material.

Sainsbury's reported its first-ever loss in its 135-year history—£39m ($71m) in the six months to September. The embattled British supermarket chain is spending heavily to revive its business, particularly its malfunctioning supply chain, as it seeks to avoid slipping further behind Asda and Tesco.

Black deeds?

Lord Black and David Radler, formerly the top two executives at **Hollinger International**, faced civil-fraud charges brought by America's Securities and Exchange Commission. They are accused of taking tens of millions of dollars from the firm without the knowledge of shareholders. Meanwhile, Hollinger agreed to sell the *Jerusalem Post* and a sister title to Mirkaei Tikshoret, an Israeli publisher, for $13.2m.

Dow Jones, publisher of the *Wall Street Journal*, agreed to pay $463m for **CBS MarketWatch**, an online financial-news and data service. Dow Jones hopes to tap the burgeoning online-advertising market to supplement its current mainly subscription-based online offerings.

Eliot Spitzer's assault on the **insurance industry** netted two more miscreants. Two executives at Zurich Financial Services' American arm pleaded guilty to offences related to bid rigging but escaped more serious charges by co-operating with investigators. Meanwhile, Zurich reported that profits were down by 31% in the latest quarter compared with a year ago, to $454m, after big payouts related to America's severe hurricane season.

American Express launched legal action against its two main rivals, **MasterCard** and **Visa**, and eight banks over alleged anti-competitive practices. Amex is seeking “billions of dollars” after America's Supreme Court said MasterCard and Visa could not fight a ruling that would allow banks to issue competitors' cards.

Custard's last stand

Kraft Foods said that it would sell its Life Savers sweets business and Altoid mints to **Wrigley**, an American chewing-gum giant, for some $1.5 billion. Struggling Kraft is reportedly hoping to sell many more businesses, including two British pudding favourites, Bird's Custard and Angel Delight, to focus on its core brands.

America's biggest flight-attendants' union called for a strike over the plans of bankrupt **airlines** to tear up members' contracts. US Airways and United Airlines both want extra cost savings from staff. The union says that carriers have used bankruptcy to cancel pensions and medical benefits, and that workers have already made hefty concessions to help failing airlines.

Hewlett-Packard's shares surged after the American computer-maker announced that profits had jumped by 27% in the latest quarter over a year earlier, to $1.1 billion. Three months ago the tech giant had sought to dampen expectations. Analysts agonised over whether this signalled a long-awaited revival in corporate IT spending.

Slipping back

Oil prices slipped to a two-month low of below $46 a barrel. Rising stocks in America coupled with predictions of a warm winter helped to ease prices, as did the news that Nigeria's main trade union had called off a strike that threatened to disrupt supplies.

Europe's leaders greeted the visit of John Snow, America's treasury secretary, with a call to prove that his "**strong dollar**" policy was not just rhetoric. The dollar sank to a new low against the euro and tumbled against Asian currencies. Mr Snow told Europe to boost demand rather than complain about a weak dollar.

Getting pricier

High energy costs pushed up **consumer prices in America** by 0.6% in October compared with the previous month, the biggest jump for five months. Inflation over the past year hit 3.2%, increasing the chances that the Federal Reserve will raise interest rates sooner rather than later.

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China's economy

Growth spreads inland

Nov 18th 2004
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The country's new prosperity used to be coastal. Now it reaches deep into the interior

THERE has never been a shortage of naive optimists about China. Among them, the British 19th-century businessman who hoped to persuade everyone there to lengthen his shirt-tail by an inch, and today's car-makers who have piled in so aggressively that over-capacity has cut margins to the bone.

Equally, though, there has never been a shortage of naive pessimists either. Throughout the 1980s, a persistent school of doom predicted that Deng Xiaoping's reforms might be thrown into reverse at any moment. By the mid-1990s that argument seemed to be settled. But a miasma of other dark fears soon arose, and has yet to dissipate. China's extraordinary growth has been uneven, worry the pessimists. Prosperity is a phenomenon restricted to the coast; in the bleak interior those left behind will rise up in revolt as they have so often before (Taipings, Boxers and the Communists themselves are variously cited). Inequality has reached critical levels; rural unemployment ditto. There are riots and protests the length and breadth of the land. It is all going to end in disaster.

The optimists were not wholly wrong, and there is some truth in the pessimists' worries. China is indeed getting more unequal as it develops, and public order is a genuine problem. But these ought to be seen as growing pains—transitional and, with luck, surmountable. Two aspects of that are a product of the extraordinary level of mobility that the Chinese workforce has exhibited over the past two decades—the more remarkable since government policy has often attempted to restrict people's freedom to move. One kind has been from interior to coast, so that the privileged growth seen there is spreading its benefits more widely than might at first appear. A second kind, visible across the whole country, has been what may rank as the most rapid rate of urbanisation ever recorded. In the past 25 years, according to admittedly highly uncertain UN figures, the percentage of Chinese living in cities has roughly doubled, to more than 40%. In 19th-century America, to cite another continent-sized country then in the throes of its own radical transformation, it took twice as long, 50 years, to accomplish the same result.

Going deeper

It is not just people who are moving; development is moving, too. Though China's seaboard is still far richer than its interior, the coast has a mighty and growing hinterland, extending back hundreds of miles. The economic dynamo that is Shanghai has lit up a corridor running much of the length of the Yangtze. And, as we report (see article), Guangdong province in the south, long one of the world's great workshops, now aspires to extend its reach a thousand miles inland, almost to the border with India. Its party secretary is promoting a plan he calls “9+2”: the creation of an integrated free-trade area as populous as the European Union, including nine provinces and the special administrative regions of Hong Kong and Macau. It is home to nearly a third of China's population.

While the idea has come from the government, its success—like so much in China—will need co-operation between bureaucracy and enterprise: in sweeping away restrictions (such as China's little-known but perverse barriers to trade between provinces) and letting private business get on with it. But a China being transformed by two such powerful poles of development as the Yangtze corridor and the Guangdong super-region, primed with capital and know-how by cities like Shanghai and Hong Kong, promises to be very different to one in which prosperity is confined to the water margin.

And there is another reason for not being spooked by the pessimists. If the standard of living of the have-nots is improving in absolute terms—as is broadly the case in China—rising inequality may be easier to stomach than in a society where the poor are getting poorer. Figures show that incomes are still rising in rural China, even if they are rising much faster in the cities. More important, perhaps, is that in a China of greatly increasing social and geographical mobility people can have real hope for their children's prospects. And China still does not look that bad in international terms. Its Gini coefficient, a measure of how unequally income is distributed, shows it to be about as “equal” as America (and more so than Hong Kong)—though again the figures are questionable and may, some say, understate a worsening problem.

The inveterate worriers, naturally, have another worry to deploy at this point. Much of China's amazing growth, averaging better than 9% a year over the past 25 years, has been built on the back of the export market. Yet it is hard to see, they think, how exports could possibly keep on growing at this rate. Indeed, they are likely to fall, if the Chinese currency is revalued, or if the American economy, where many of them still go, starts to slow down. In fact, though, it is increasingly likely that China will be able to withstand such a downturn. For a start, its economy, though trade-dependent, is not excessively so. Its ratio of exports to GDP stands at around 30%: high by the standards of America and Japan, but nothing out of the ordinary compared with European or other East Asian nations.

As prosperity spreads, and more and more Chinese people are able to start affording life's little luxuries, China's domestic economy is starting to become a powerful engine of growth in its own right, just as happened earlier in Japan and, indeed, in America before that. Sustaining all this won't be easy. The Communist Party remains a significant obstacle to the unfettered development of the domestic private sector, thanks to its insistence on protecting inefficient state-owned firms that ought to go bust but instead are allowed to undercut more productive concerns.

All that said, however, China is for the foreseeable future going to be the world's lowest-cost manufacturer of most household items, despite growing competition from Vietnam and India. So the process of allowing its hundreds of millions—deprived of material comforts by the insanities of Maoism—to catch up must in the end guarantee a healthy home market. Caution about China is in order: it has gigantic political and social problems, not to mention severe energy shortages and a terrifying level of bad debt. Pessimism, though, is not.

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The Bush reshuffle

Farewell Colin, hello Condi

Nov 18th 2004
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A change that should be for the better

AP

IT HAS replaced Kremlinology as the main diplomatic parlour game. With each change of the guard, outsiders rush to draw dramatic conclusions about factional infighting and ideological power struggles; and then they are usually forced to revise them. Instead of Politburo hardliners, Georgian satraps and Moscow modernisers, we now have Bush loyalists, neo-conservatives, assertive realists, traditional internationalists, Pentagon hawks and State Department doves.

This week saw the departure from the Bush administration of the supposed head dove. Colin Powell, George Bush's secretary of state, resigned, and was replaced by Condoleezza Rice, hitherto the national security adviser. Because Mr Powell was seen as the most internationalist member of the administration and Ms Rice (no mean real Kremlinologist, incidentally) is seen primarily as a Bush loyalist (with a bit of assertive realism thrown in), many Bushologists in Europe have jumped to depict the change as a shift to the right. It need not be.

The European view is that Mr Powell was always an internationalist and that he lost all his battles inside the administration. Neither is strictly true. Far from opposing the administration's most controversial policies, Mr Powell ended up to the fore in the Iraq war. He certainly was a moderating, multilateralist influence on Mr Bush (particularly in partnership with Tony Blair) but some of his battles with Donald Rumsfeld, the defence secretary, had less to do with ideology than with familiar turf squabbles between the Pentagon and State.

As for his achievements, Mr Powell sadly leaves office a diminished figure. Four years ago, he was seen as presidential material. Mr Powell seems to have found high office something of a strain. Perhaps for that reason he never travelled enough. But he did win plenty of the struggles he undertook—from refashioning America's relations with China to persuading Mr Bush to go back to the United Nations over Iraq (both blows to those supposedly omnipotent neo-conservatives).

What of Ms Rice? She offers one straightforward advantage over Mr Powell: she is less likely to be at odds with Mr Bush, so there will be fewer mixed signals. The promotion of Stephen Hadley, Ms Rice's deputy and another Bush loyalist, to be her successor at the NSC is also to be welcomed. Much depends, however, on two unknowns.

The first is the sphinx-like Ms Rice herself. As with Mr Bush himself, she seems in the past four years to

have swayed between those different factions. She remains a committed supporter of hard power and Mr Bush's steely pledge to bring democracy to the Middle East; but she also seems aware of the “soft” need to redeem America's reputation in Europe and the Arab world, if only on the pragmatic ground that America cannot achieve what it wants alone. Those are good instincts; they will require a flintier resolve than Ms Rice showed as national security adviser (see article).

The other unknown is Mr Bush's other changes. The vacancy list includes Ms Rice's own deputy at the State Department. But the most urgent change should be the removal of Mr Rumsfeld. This has nothing to do with ideology, and everything to do with pragmatism. Mr Powell may have been America's official face abroad, but the things that have proven so disastrous to America's image and its effectiveness—Abu Ghraib, Guantánamo Bay and the mismanagement of the occupation of Iraq—all fell firmly in Mr Rumsfeld's patch. Ms Rice, Mr Bush and America need a fresh start.

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Iraq and its neighbours

It's time to help

Nov 18th 2004
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Iraq's neighbours can help bring the country gradually back to normality

HOWEVER much Arabs, Turks and Iranians blame the Americans for making a mess of the Middle East—and most of them, with varying degrees of virulence, certainly do—they at least tend to agree on one thing: that chaos, especially in today's Iraq, benefits nobody except those who share the apocalyptic vision of Osama bin Laden and his friends. Hence, next week in the Egyptian resort of Sharm el-Sheikh, it is to be hoped that an unprecedented gathering of all Iraq's six neighbours, plus representatives from the G8 group of rich countries, the European Union, the Arab League, the Organisation of Islamic Conferences and the United Nations, will pull together to help Iraq's American-backed interim government in its fraught campaign to drag the country to a more or less fair election in January.

Can it be done? The past week has witnessed more than the usual footage of horror and mayhem. Most shocking was a videotaped film apparently of Margaret Hassan, the head of CARE International in Iraq, who had British and Irish nationality and was married to an Iraqi, being shot in the head, weeks after she had been kidnapped in Baghdad by fanatics unknown. No less grisly, in many eyes, was an American television film of a marine shooting a wounded Iraqi rebel during the battle for Fallujah, in lukewarm if not cold blood. And the sight of Fallujah's streets, smashed by American artillery and littered with corpses, was hardly an advertisement in the campaign for Iraqi hearts and minds.

But the road to an election was bound to be fraught, and the decision to assault Fallujah in the hope of destroying the nerve-centre of the most extreme of the insurgents was taken in the full awareness of heightened political risk. So far it is unclear whether, in the longer run, the recapture of the town has made the overall political outlook worse or better (see article). Most people in the largest portions of Iraq, where Shias and Kurds predominate, still seem likely to vote. The national lists of the main party alliances should contain some Sunnis. But the biggest worry is that if few Sunnis in the areas where they predominate dare to vote, the result will be deemed illegitimate and the insurgency will not abate.

Many Arab regimes feel queasy at the prospect of such a genuinely multi-party election (something none of the Arab League's 22 countries has managed of late), especially one that is bound to produce a government led by Shia Muslims. In the eyes of many of the 90% of Arabs who are Sunni, particularly the Saudis, the Shia creed is beneath contempt. The Turks and Iranians have other reasons to feel uneasy. The former do not like the emergence, in northern Iraq, of a bumptiously self-governing Kurdish entity that could act as a magnet or encouragement to their own large Kurdish minority. And the Iranians, though smiling at the sight of Arab co-religionists coming to power, are nonetheless wary of helping any government allied to the Great Satan. As for Syria, Iraq's other awkward neighbour, it may go on turning a blind eye to insurgents slipping across its border into Iraq, so long it continues to feel the cold wind of American hostility.

A flicker of hope

Yet fear of chaos, for most of Iraq's neighbours, should outweigh their dislike of a new, American-confected order next door. They should be doing their bit to bring about an adequate election. In particular, that means urging Iraq's Sunnis to stand up to the insurgents in their midst in return for promises of fair representation in a new government. It also means stemming all moral and material support for the gunmen.

Some peace-minded Sunnis, perhaps including the interim president, Ghazi al-Yawar, think the election should be delayed. The period, soon to end, for voters and parties to register could be extended. If there were signs that the insurgency, in the wake of Fallujah's subjugation, were being contained, a brief postponement of the vote for, say, three months should be considered. But if Iraq's insurgency looks too well dug in, it may be best, as Mr Allawi apparently thinks, to hold an election where possible, while promising those in the Sunni triangle a poll when feasible. That would be far from satisfactory. But it may be the best on offer, for Iraq and its neighbours.

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The United Nations

Time for a re-think

Nov 18th 2004
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New threats need new answers

Reuters

Get article background

SOME things are doomed to remain imperfect, the United Nations among them. Despite noble aspirations, the organisation that more than any other embodies the collective will and wisdom of an imperfect world was created, in the words of one former secretary-general, not to take humanity to heaven, but to save it from hell. Is it failing in that task?

Alarmed at the bitter dispute over the war in Iraq, and at growing threats—from the devastation of AIDS and the danger of failing states to the prospect of terrorists armed with weapons of mass destruction—that the UN's founding powers hadn't even had nightmares about, last year Kofi Annan, the current secretary-general, asked a group of eminent folk to put on their thinking caps. Their report on how the UN might in future better contribute to international peace and security—mobilising its own and the world's resources to prevent crises where possible and to deal with them more resolutely and effectively where necessary—is due for delivery in two weeks' time (see article). Yet the thoughtful debate such proposals deserve risks getting lost in the poisonous war of words between UN-baiters and UN-boosters, and in the fisticuffs over what governments seem to care about most: who will get any extra seats that may be up for grabs on the Security Council.

The might-is-always-righter brigade, who brush aside the UN as irrelevant in today's world, are small in number but can seem troublingly influential. They are also dangerously short-sighted. Like other big powers, and plenty of smaller ones, America fosters the UN when it needs it, and sometimes circumvents it when it doesn't. But wiser heads recognise that being the world's most powerful country and top gun has its problems. With global interests and global reach, America is most often called on to right the world's wrongs. It should have keen interest in a rules-based system which keeps that burden to a minimum and finds ways for others, including the UN, to share it. What is more, as China, India, Japan and others put on economic and military muscle, having agreed rules for all to play by as much as possible makes strategic sense too.

Yet the not-without-UN-approval school can be equally off the mark. For the system of international rules, treaties and laws is still a hodge-podge. Some, like the UN charter itself, are deemed universal, though they may at times be hotly disputed and sometimes ignored. Others, such as the prohibitions against proliferation of nuclear, chemical or biological weapons, are accepted by many, but not all. Some disputes can be settled in court—boundary disputes by the International Court of Justice, for example, accusations of war crimes or genocide by the International Criminal Court—but only where governments give the nod. For the rest, the UN Security Council is where most serious disputes end up.

And there the trouble can start. The council is not the moral conscience of the world. It is a collection of states pursuing divergent interests, albeit—one hopes—with a sense of responsibility. Where it can agree, consensus lends legitimacy to action. But should action always stop where consensus ends?

There was nothing high-minded about Russia's refusal to countenance intervention in Kosovo in 1999 to end the Serb army's ethnic cleansing there; it was simply protecting a friend. Might, concluded NATO governments in acting without council approval, is not always wrong. Over Iraq, it is debatable what did more damage: America's failure to win support from the council before going to war anyway, or the hypocrisy that had allowed Iraq to flout all previous council resolutions with impunity.

Better intentions are not enough

Getting the council to mean what it says would help restore some lost credibility. Getting it to evolve its collective thinking about international legal niceties in tune with evolving threats, as the upcoming report is likely to propose, is vital too. It has lately learned to lean harder on genocidal dictators, despite wariness about infringing on the idea of “sovereign immunity”. Now it needs to contemplate earlier and sometimes even forceful action, by itself or others, against threats, such as nuclear proliferation, where delay could invite catastrophe.

Might making the council more representative help? Its edicts would seem more legitimate in parts of the world that have felt disenfranchised by permanent members that are seen as cold-war hold-overs. But without a greater readiness to see the new threats more clearly and act on them, a larger council will simply multiply the divisions. All the more reason why Mr Annan's eminences deserve a proper hearing.

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Auditing

Half measures

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The auditing industry still needs more reform

IN THE three years since accounting shenanigans at Enron first came to light, followed quickly by accounting scams at WorldCom, Parmalat and others, the auditing profession has been trying to sort itself out and steer clear of trouble. But accounting scandals continue to surface—most recently at Fannie Mae, America's giant mortgage company. More trouble may be brewing: in the newest twist in America's unfolding insurance-company scandal, regulators have recently launched investigations into companies' use of certain insurance products to “manage” earnings. Should they unearth dodgy doings, the auditors who signed off on company accounts could find themselves in hot water. Indeed, Deloitte & Touche, the world's biggest audit firm, faces a lawsuit of up to $2 billion for its audit of Fortress Re, a re-insurance firm that allegedly used certain insurance products to inflate profits.

The continued inability of auditors to thwart accounting trickery means that, even after the flood of reforms put in place after Enron's collapse, the industry remains a problem. The concentration of the industry into the “Big Four” accountancy firms—Deloitte, PricewaterhouseCoopers, Ernst & Young and KPMG—that now audit the lion's share of the world's large, public firms heightens these concerns (see article). Given the implosion of Arthur Andersen, Enron's auditor and once the fifth-biggest accountancy firm in the world, after a criminal indictment for obstruction of justice, there is a real question about how aggressively regulators can now pursue the surviving four big auditing firms for any future misconduct. Would the world's financial system really be safe with just the “Big Three” or “Big Two”, or even a single giant firm auditing most large corporations? That sounds untenable.

It is all the more important, then, that the rules governing the audit industry itself are sound. Certainly, these are in better shape today than they were five years ago, at least in America. The Sarbanes-Oxley act passed in the wake of the Enron and other scandals made non-executive directors on company boards, rather than company management, responsible for hiring and firing auditors, and created an independent oversight body to inspect accountancy firms regularly.

Yet more still needs to be done. Accountancy firms remain riddled with conflicts of interest. The most basic is that they are responsible for auditing managements that, ultimately, pay them to do so. Often, auditing relationships span decades, increasing the likelihood that familiarity breeds over-cosy ties. And while, ideally, audit firms would compete on the basis of reputation, so that providing the highest quality audits and maximising profits would go hand in hand, in the real world this applies at best imperfectly. Each of the Big Four accountancy firms and many of the second-tier ones have been sullied by accounting scandals, yet they continue to attract business because there are no other options, particularly for large, international companies. The professions' shift from a pure-audit model to a multi-

disciplinary one, in which accountancy firms provide companies with tax, advisory and other services along with audits, only increases the potential for conflicts of interest.

Fending off future fiddles

There is no single or simple solution to the over-concentration of the auditing industry. Nor could any regulatory changes eliminate scandals altogether. But recent changes could be taken another step. Sarbanes-Oxley, for example, requires the periodic rotation of the senior partner on audit teams and bans accountancy firms from providing certain (but not all) non-audit services to their audit clients. So why stop half way? The goal of audit reform must be to reduce potential conflicts of interest as much as possible. This should mean requiring the periodic rotation of entire audit firms, and not just the audit-team leader. A ban on the provision of all non-audit services to audit clients by the same accounting firm should also be adopted. And European countries, most of which lag America, should act as soon as possible to put similar rules in place.

Such reforms could well require wide-ranging changes among the Big Four accounting firms themselves, and might open the way to competition from other firms for tax, advisory and other non-audit services to the world's biggest firms. The Big Four would object. However, the rules should not be tailored to suit them, but to serve the wider public interest and that of shareholders. Given the critical role that auditing firms play in the financial markets and in checking management behaviour, to do any less would be irresponsible.

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Bans

No smoking, foxhunting, sugar, salt, fat...

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From The Economist print edition

What the government should and shouldn't do to make people live better lives

ENJOYING yourself? Well you'd better stop, then. This week is banning week in Britain. The government has, as near as dammit, banned both smoking in public places and foxhunting (see article and article), as well as making it clear that it takes a very dim view of those who eat too many burgers and too few carrots.

For those who take their pleasures where they can get them, it looks as though the government has succumbed to a nasty bout of gloomier-than-thou Methodism. It wouldn't be surprising: the roots of the Labour movement lie in the finger-wagging of 19th-century preachers. But puritanism is not the only thing going on. Behind the government's apparent determination to make people lead better, purer lives whether they like it or not lie two different impulses, one decent, one not.

That old chestnut

The foxhunting ban, which the government seemed certain to force through Parliament as *The Economist* went to press, falls into the second category. If the primary motivation behind it were animal welfare, the government would have banned much of what goes on in modern farming long before it paid attention to exactly how a few thousand foxes die every year. Labour MPs want to ban foxhunting not because they want to help poor animals but because they want to hurt rich people. Foxhunting, it is thought, is what the upper classes in the countryside do, and no amount of parading black foxhunting nurses in the newspapers will dispel this idea.

Tony Blair, who has a mild aversion to the countryside but also to class-based politics, had no appetite for such a ban, but unwisely succumbed to MPs' demands at a moment of weakness earlier this year. He subsequently realised his mistake, but it was too late. The party was baying for the foxhunters' blood, and finally got it.

If the foxhunting bill is not really concerned with animal welfare, the public health white paper published this week is at least genuinely about people's welfare. Governments have been telling people for decades that smoking is killing them, and although lots have been sensible enough to give up, a rump of 26% of the population obstinately sticks to the weed. At the same time, dieticians and politicians have been banging on at them to skip the chocolate bars, eat up their green veg and do more exercise, but too

many still refuse to. What's more, the smokers and chocolate-munchers are disproportionately poor, which makes the left feel especially uncomfortable. If the poor refuse to help themselves, it feels, something must be done to help them.

The question of just how much should be done reaches right down into the principles underpinning liberal democracy. According to those principles, the government is entitled to interfere with people's behaviour only in so far as it affects other people. Otherwise, well-informed individuals should be allowed to make their own choices. If they want to harm themselves, that's up to them.

That's why the government has tried to sell the smoking ban in the way it has. Passive smoking, it argues, kills other people. Yet the numbers involved are tiny: according to the latest research, an average of 49 workers in British pubs or restaurants die every year from passive smoking. Anyway, workers too have choices. What's more, most passive smoking happens in the home; and preventing people from puffing away in their living rooms would involve a level of illiberalism which not even this government is prepared to countenance.

But, says the government, the number of people killed by passive smoking is only part of the problem. Non-smokers also have the right to enjoy a non-smoky environment when they go out in the evening. Well, if there are enough of them, the market will cater for them; and, increasingly, it is doing so. Smoking has gone from aeroplanes, trains, buses and even most football grounds. Most restaurants, these days, have non-smoking areas; many ban smoking altogether. As smoking declines, so do the number of venues that allow it.

All very well, say those who want tough measures on cigarettes and junk food; but unhealthy people are a burden on the health service, and are therefore subsidised by those who do all that their doctors tell them. That's certainly not true for smokers: they keel over so early and so quickly that, even before the extra tax they pay is taken into account, they probably save the state money. Fat people do cost the health service extra, but then so do people who have children, and the government isn't yet proposing to charge them extra for the privilege.

What the government should be doing (since the market won't) is informing people. The main reason why so many people have given up smoking is that governments have been drumming into their heads that they are giving themselves lung cancer, hardening their arteries, destroying their fertility, damaging their circulation and making their teeth drop out. Smokers have been made to feel stupid; which, since they are, is just as it should be.

The proposal in the white paper for comprehensible food labelling is therefore an example of just the kind of thing that governments should be doing. Current food labels are useless: consumers are offered a long list of substances which, as far as they know, might either be warding off cancer or poisoning them. The government does not have much idea how to improve it. It could do worse than import America's system, which tells consumers what proportion of the recommended daily intake of, say, salt each lethal snack-food contains. Stronger public education campaigns could also help.

Let them eat chocs

There's an inevitability about the proposed smoking ban. It has swept across the Atlantic, like so many other social trends, from rock and roll to political correctness, is now lapping at the shores of western Europe and will soon move on to the mainland. But change is not always progressive. Liberal democracy demands that governments should inform people, then leave it up to them to make their own mistakes. If they want to be fat, smell like ashtrays and die early, let them.

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Letters

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Disunited states

SIR – I am sick and tired of calls for George Bush to reach out to the rest of the world and heal wounds ("Now, unite us", November 6th). This is nothing less than a call for America to compromise its convictions for the sake of world favour. Why is no one calling for the rest of the world to compromise its ideals? Let Michael Moore and his like move to Europe if they revere that continent's values so highly. We have nothing to gain by compromising with Europeans or anyone else. Most Americans could not care less whether we are loved or not, as long as the rest of the world respects us.

Roger McKinney
Tulsa, Oklahoma

SIR – Mr Bush's attitude after his victory resembles more a tyranny of the majority than a mandate. A three percentage-point margin of victory does not give licence to execute a political agenda at full force. This country is deeply divided. To claim that Mr Bush has a mandate will only entrench the divisions.

John Mast-Finn
Columbus, Ohio

SIR – Every election I read about the "two Americas". I have been happily married to someone from the "other" America for 14 years. I watched as she proudly mailed her ballot for John Kerry. Even with Mr Bush's win we have been getting along just fine, as always. In fact, to console her, I plan on buying her a nice gift with some of the tax savings Mr Bush provided me with.

Tim Patronik
Cheltenham, Gloucestershire

Poor reflection

SIR – Blame for the fiasco of the mirror in the *Hubble* space telescope was decidedly not the fault of the contractor, Lockheed Martin ("D'oh!", October 23rd). Blame can be laid right at NASA's door. Yes, PerkinElmer fluffed the configuration of the mirror but NASA decided not to spend the money to test it. Lockheed made strong science-based objections but the customer is always right, even if fatally stupid and misguided.

Lee Carrau
Phoenix, Oregon

Europe's next recruit

SIR – The European Union is poised to admit Romania ("Brussels beckons", November 6th). It is unsettling that the country's pre-1989 communist system has been broken up far less completely than in any other former-Soviet satellite. Second- and third-level apparatchiks have distributed state assets among themselves in the name of privatisation and preside over a "managed democracy" with acute shortcomings. In a close election set for November 28th widespread irregularities are likely. Indeed, the reluctant democrats in charge will be emboldened to massage the results now that top politicians from the EU are so extravagant in their praise of the mediocre record of the outgoing prime minister, Adrian

Nastase.

The luck of the predatory group running Romania will spell misfortune for millions of ill-used citizens who want to join the EU in the proper way. It could also be the turning point that reveals how completely the Brussels leviathan has broken faith with the ideals of its founders.

Tom Gallagher
Department of peace studies
University of Bradford,
Bradford, West Yorkshire

Don't mention the war

SIR – Your article on Germanophobia in Britain reminds me of when I first moved to Britain from Munich ("War bores", October 30th). I was perturbed to be authoritatively informed that my highly cultured home is, in fact, "full of Nazis". The British insistence on clinging to outdated stereotypes of the Germans as Nazis (and to outdated notions of themselves as a great power) is a constant source of both amusement and frustration. And it does a great disservice to the civilised, tolerant and enviable state of life in modern Germany. Rather than telling the Germans not to forget their history—something that they have never sought to do—the *Daily Mail* and its readers might do better not to lose sight of the present.

Nathaniel Kent
Oxford

A little bit safer

SIR – Your chart ranks Medellín as the most violent city in Latin America ("The battle for safer streets", October 2nd). However, the statistic you present for 2003, with nearly 140 murders per 100,000 inhabitants, in fact is that for 2002. Last year, the rate fell to 98 murders per 100,000; and this year we are expecting a rate of 48. This places Medellín at the average level of other places in Latin America such as Mexico City or São Paulo. We have left behind the worst times. We still have plenty of work to do, but it is about time that we got the recognition we deserve instead of bad publicity based on a stereotype that no longer rules.

Sergio Fajardo Valderrama
Mayor
Medellín

Deconstructive criticism

SIR – It seems uncharitable to have assigned your obituary of Jacques Derrida to a zealous antinominalist, who gave us more polemic than context (October 23rd). But at least you had the grace to recognise that Derrida can be seen as part of a school of thought (and intellectual battle) as old as western philosophy itself, dating back to the pre-Socratic era.

Perhaps the last word should go to Lewis Carroll:

> "When I use a word," Humpty Dumpty said, in a rather scornful tone, "it means just what I choose it to mean—neither more nor less." "The question is," said Alice, "whether you can make words mean so many different things." "The question is," said Humpty Dumpty, "which is to be master—that's all."

Keith Macbeath
Fort Lee, New Jersey

SIR – What are the grounds for your condescending defence of Derrida against the charge of charlatanism? If he was "confused", as you contend, and if there "were no arguments, nor really any views" in his texts, he must have used some magical device to convince so many intelligent people that he had something to say.

Matyas Havrda
Prague

Next in line

SIR – Hillary Clinton may be the best person to lead the Democratic Party and America into the next election but her nomination would guarantee a Republican victory (Lexington, November 6th). America is a highly conservative country. Conservative values include notions of appropriate roles for women. Mrs Clinton is viewed with great suspicion or is even despised in much of rural, suburban, Christian America. Unfortunately, the Democrats need to find themselves another Bill Clinton—charismatic and from a humble rural or suburban background—if they want to win in 2008.

Wendy Waters
Vancouver

SIR – If Lexington believes that there will be another Democratic presidential candidate from either the north-east or the Senate before 2024 he is either in need of or has had a little too much medical marijuana.

Del Altwood
New Glasgow, Canada

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United Nations

Fighting for survival

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A preview of a report that may help to rescue the rule of law

Get article background

THE United Nations and the rule of international law are in crisis. Their relevance is being questioned as never before. The criticism reached such a pitch after last year's Iraq war that many wondered whether a body increasingly seen as ineffective and anachronistic could, or indeed should, survive.

“Rarely have such dire forecasts been made about the UN,” its secretary-general, Kofi Annan, said in his annual report to the General Assembly last year. “We have reached a fork in the road...a moment no less decisive than 1945 itself, when the UN was founded.” On December 1st, he will receive a report by a high-level panel on collective security in the face of the new global threats. It is a report that may help in deciding the organisation's fate.

The UN was set up to “save succeeding generations from the scourge of war”. It has not been very successful. Countries have repeatedly taken up arms against one another with impunity (as many as 680 times between 1945 and 1989, according to one count). Hundreds more conflicts have taken place within states.

“No universally accepted practice currently governs the use of military force,” says Gareth Evans, a former Australian foreign minister who heads the International Crisis Group and is one of the leading lights on the panel, “States are going to war when they should not be, and not taking military action when they should. We have something approaching a crisis of confidence in the reality and relevance of the global legal order.”

The panel, set up by Mr Annan a year ago, is chaired by Anand Panyarachun, a former Thai prime minister. Its 16 international worthies include Brent Scowcroft, who was national security adviser to George Bush senior (and a mentor of Condoleezza Rice, the current president's newly appointed secretary of state); Yevgeny Primakov, a former Russian prime minister; Qian Qichen, a former Chinese foreign minister and vice-premier; Gro Harlem Brundtland, former Norwegian prime minister and ex-head of the World Health Organisation; David Hannay, former British ambassador to the UN; Satish Nambiar, a former general in the Indian army; and Amre Moussa, the Egyptian secretary-general of the Arab League.

A distinguished international group, but not everyone was impressed. The panelists, nearly all retired, have an average age of over 70. “Relics trying to reform a relic,” one UN ambassador observed unkindly. But the decision not to include serving politicians and officials was deliberate. Mr Annan was determined that his wise men (and two wise women) should not get bogged down in national rivalries and so produce

some anodyne lowest-common-denominator report. With George Bush warning the UN that it was in danger of “fading into history as an ineffective, irrelevant debating society”, the stakes were too high. But nor was there any point in the group coming up with such radical ideas that they had little chance of approval by the UN's 191 member states.

Ever since the UN's creation, there have been mutterings about the need for reform. But, despite huge upheavals in the world, little has altered. Many began to wonder whether the ageing, unwieldy body was even capable of change. The Iraq war has acted as a catalyst, bringing the organisation's inadequacies into starker relief than ever before. More than a dozen Security Council resolutions were passed against Saddam Hussein in as many years, yet not one of them was fully enforced. When America asked the Security Council for authorisation to attack a country by which it considered itself threatened, it found its way blocked. So it acted on its own with a “coalition of the willing”.

This, Mr Annan recently declared, was “illegal” in so far as it was “not in conformity with the UN Charter”. Most international lawyers agree. Not surprisingly, America, and its chief ally, Britain, do not. But whatever the legal rights and wrongs of the invasion, the danger of states taking the law into their own hands, discounting the legitimacy of the UN, is evident. Such action, Mr Annan told the General Assembly last year, “could set precedents that result in a proliferation of the unilateral and lawless use of force, with or without credible justification.”

So what to do about it?

Stock responses of containment and deterrence are no longer sufficient in the face of the new global threats of international terrorism, perhaps armed with weapons of mass destruction. It was not enough, Mr Annan conceded, to denounce unilateralism, unless the world also faced up squarely to the concerns that make some states feel vulnerable, and thus driven to take unilateral action. The UN must show that those concerns could, and would, be addressed effectively through collective action, he said. This is now the biggest challenge facing the UN.

It was also the main task that Mr Annan set his wise men. Judging by what has been leaked about the report, they have succeeded, against expectation, in agreeing on a new set of basic ground rules that lay down when the UN should resort to force. In an article entitled “When is it right to fight?” in the current issue of *Survival*, a quarterly journal of the International Institute for Strategic Studies, Mr Evans sets out ideas that are understood largely to reflect the panel's own thinking.

In the aftermath of Iraq, some commentators, mostly American, went so far as to claim that the UN's whole edifice had come crashing down and that there simply were no rules any more. Mr Evans dismisses this as alarmist nonsense. All the necessary legal tools and rules for military action are already to hand, he insists, in the UN charter's Article 51 and Chapter VII provisions. If properly applied, these tools allow for a full range of responses—reactive and preventive—to all likely future security threats. What is needed is a better process to maximise the chances of reaching a consensus.

The new ground rules

To this end, he, and it seems the panel, propose the adoption of five basic “criteria of legitimacy” as guidelines for the use of force in all cases—whether self-defence, external armed conflict or internal crises that involve gross violations of human rights. The five are: the seriousness of the threat (is it sufficiently clear and serious to warrant military force?); proper purpose (the prime intention must be to halt or avert the threat, whatever other motives are involved); last resort (has every non-military option for meeting the threat been considered?); proportional means (the scale, duration and intensity of the proposed military action must be the minimum necessary); and the balance of consequences (there must be reasonable prospects of success; force cannot be justified if it is likely to make matters worse).

Under the charter, the use of force is permitted in just two cases. First, under Article 51, in self-defence “if an attack occurs” (a phrase inserted at American insistence). Second, under Chapter VII, if authorised by the Security Council in the event of a breach of, or threat to, world peace. Under customary international law, a pre-emptive strike in self-defence has also long been permitted where an attack is “imminent”. No one has ever seriously suggested that you have to wait to be fired upon.

But a preventive (as opposed to pre-emptive) strike in self-defence—one designed to head off a more

distant suspected threat—is not permitted under Article 51. This requires a Chapter VII authorisation by the Security Council. Yet in a world of lethal weapons, where annihilation could come without warning at a press of a nuclear button, it is unreasonable to expect a country to wait until an attack is imminent. By then, it would already be too late, the panel concedes.

Nevertheless, it firmly rejects any expansion of the scope of self-defence under Article 51. Instead, it urges the Security Council to consider the early authorisation of action against certain types of urgent but non-imminent threats, such as terrorist groups that are about to acquire weapons of mass destruction. This is something that Mr Annan has already suggested. Once the council has determined the existence of a threat to peace, even if it is quite a distant one, it then has virtual carte blanche to call for measures "to maintain or restore international peace and security".

If it decides that an internal conflict amounts to a threat to international peace, it can also authorise armed "humanitarian" intervention—as it did in Somalia and later in Bosnia in the early 1990s. But the council is often painfully slow to respond, if it responds at all. Witness the current and continuing slaughter in Darfur.

Three years ago Mr Evans co-chaired a committee set up by Mr Annan to study the competing claims of state sovereignty and individual rights. It recommended a new "responsibility to protect", ie, that the international community (read the UN) had not simply a right, but a responsibility to act to protect the people of a country when that country itself abdicated responsibility. This idea had begun quietly to gain momentum, Mr Evans says, when it was thrown off course by one of the *ex post facto* justifications for the Iraq war: that the invasion was necessary on humanitarian grounds. The panel would now like the principle to be formally adopted.

The wise men regard their success in winning unanimous agreement on a definition of "terrorism" as one of their greatest achievements. Hitherto, attempts to find an acceptable definition have always foundered on the insistence of the Organisation of Islamic Conferences and its 56 member states that it exclude "armed struggle for liberation and self-determination". Now even Amre Moussa, the only Arab member of the panel, has accepted that any politically motivated violence against innocent civilians should be regarded as terrorism, and condemned.

As a sweetener for Mr Moussa, the group agreed to include a recommendation that all states be held more rigorously to their obligations under international law, including the rules governing occupation. This is an evident dig at Israel's conduct in the Palestinian occupied territories, as well as at America's actions in Iraq.

But if the UN is to do more to assert its moral authority and to lead the way in combating international terrorism, its authoritative body, the Security Council, needs to have much greater, and more recognised, legitimacy. The rules, drawn up by the allied powers while the bombs of the second world war were still falling, provided for a council of five veto-wielding permanent members (the four main victors in the war—America, Russia, Great Britain and China—plus France) and six non-permanent members, later increased to ten, elected on a regional basis for a non-renewable two-year term.

Anachronistic council

Dominated by rich white nations, the UN's main decision-making body has long been regarded as undemocratic and out of touch with modern geopolitical realities. Why, for example, should Britain, with its 60m people, have a permanent seat and not India, with more than a billion? Why should Russia with a GDP the size of Belgium's have one and not Japan, the world's second biggest economy? Why doesn't a single African, Latin American or Muslim country have permanent status?

The arguments have been around for ages. But if the council is to regain credibility, particularly with the world's poorer countries, it must be made more representative. This summer, the panel thought it might have hit on a winning formula. It proposed an expanded 24-member council comprised of three tiers: the existing immovable permanent five; a new second tier of seven or eight semi-permanent members elected on a regional basis for a renewable four-year term; and an expanded bottom tier of rotating members elected on a regional basis, as now, for a non-renewable two-year term. Only the permanent five were to have a veto.

But when the panel's views were leaked, the four countries with the highest hopes of a seat at the top table—Japan, Brazil, India and Germany—launched a ferocious joint campaign against it. They are

determined not to be fobbed off with second-class status. They point out that the charter sets two criteria for assessing council members: contribution to the UN's work (Japan and Germany are the second- and third-biggest contributors respectively to the UN's budget) and equitable geographic distribution.

Naturally, each one of the “aspirant four”, as they are known, has its fierce detractors. Pakistan cannot abide the idea of India getting permanent status; China is appalled by the prospect of Japan, its old enemy, joining it at the top table; jealous neighbours oppose Brazil; and Italy, always nervous about being left out in the cold by Europe's “big three”, is conducting a vigorous campaign against Germany's candidacy, arguing that there should be just one permanent European seat representing all the EU's 25 member states.

In any event, the aspirant four's campaign did for the three-tier proposal. Although it will still be included as a possibility in the panel's final report, a second option is now regarded as the front-runner. Based on proposals first put forward seven years ago by a UN committee, chaired by Razali Ismail, it again calls for an expansion of council membership from 15 to 24. But this time it would include six new permanent members—almost certainly the aspirant four, plus two African countries, one from the Arab north (probably Egypt) and one from the sub-Saharan south (probably South Africa). There would also be three more regionally elected non-permanent members.

Maybe, this time

Pessimists point out that every attempt to change the council's composition over the past 40 years has failed. Why, they ask, should this proposal have any greater chance of success? Because, say the aspirant four, for the first time they are co-ordinating their bids in a single mutually supportive group. As such, they believe they are more likely to get the necessary two-thirds vote of the General Assembly. But they must also not attract any opposing vote from the permanent five. American officials say in private that they favour only one new permanent member—and that would be Japan—and would accept only a “small expansion” of the total membership. Anything more than 20 would almost certainly be regarded as too much.

The panel seems to have decided to duck the tricky question of veto rights, at least for the moment. Publicly, Germany, Japan, India and Brazil are all demanding a veto. Unofficially, most, if not all, of them would be prepared to bargain it away in return for permanent status.

The decried veto system has often been responsible for the council's (usually) lamented failure to act. As a way round this, the panel considered resuscitating the so-called “uniting-for-peace” resolution under which the General Assembly can “recommend” measures, including the use of force, to counter a threat to international peace if the council is blocked. This was used by America in 1950 as a way of avoiding Soviet steps against intervention in the Korean war, but has long fallen into disuse, though it was recently considered in relation to possible action on Israel's security barrier. In the end, the panel seems to have rejected the idea of reviving it, believing it could open a Pandora's box.

No cop at nation-building either

If the UN is failing to fulfil its responsibilities in keeping the peace, it is even further behind in helping collapsed states to put themselves together again. At present, around 40% of post-conflict countries fall back into fighting for want of adequate support in matters such as policing, the organisation of elections, training new judges and so on. The panel believes more could be done if all the relevant actors were brought together. This would be either in some new centre within the secretariat or, more controversially, in a nation-building commission directly under the Security Council, which would include regional institutions and major donors such as the World Bank and the IMF.

But, like much else in the panel's report, this suggestion will have difficulty gaining acceptance. Some of the proposed changes will need charter amendments. This requires approval by at least two-thirds of the General Assembly, with no counter vote by any of the permanent five, followed by ratification by at least two-thirds of the member states. Other proposals might simply require adoption by the Security Council. But this, too, is likely to be far from easy.

Thumbs down from America?

America's attitude will be crucial. Does Mr Bush really want a stronger, more effective UN? Some in his administration are contemptuous of world bodies that attempt to restrain American's freedom to act. American neo-conservatives, exasperated by the UN's bureaucratic slowness, inefficiency and alleged anti-Israeli bent, regard it at best as a necessary evil, at worst as a corrupt talking shop. Delegates at this summer's Republican convention erupted in deafening applause when Dick Cheney, the vice-president, said that Mr Bush would “never seek a permission slip to defend the American people”.

If the leaks to this paper about the report are near the truth, the wise men have produced nothing very earth-shattering. But to have done so would have been counter-productive: revolutionary ideas would have been dead on arrival. On the other hand, the great and good have come up with some surprisingly bold and interesting ideas. Implementing them, however, is quite a different matter.

Mr Annan is expected to give his views on the panel's recommendations (and there are nearly 100 of them) when he reports next spring on the UN's “millennium development goals”. These goals, agreed by world leaders in 2000, covered peace and security, human rights and good governance as well as targets for halving extreme poverty and hunger by 2015. Mr Annan will then submit his report to a world summit at the UN's New York headquarters just before the General Assembly convenes next September.

Many believe this could be the UN's last chance of reforming itself for a very long time. But the question goes far beyond the customary meaning of “reform”. The principle at stake is whether the world accepts that its armed actions should be governed by commonly agreed rules of international law. Strobe Talbott, a deputy secretary of state under Bill Clinton, cynically notes the alternative: “The sheer pre-eminence of American power could, in itself, be the ordering and taming principle of a disorderly and dangerous world.”

The poor old United Nations is indeed a flawed and defective organisation: the action, or more often the inaction, of its members, as well as its own intrinsic faults, have made it so. But, as its secretary-general warned the General Assembly last September: “Let's not imagine that, if we fail to make good use of it, we will find any more effective instrument.”

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The Bush reshuffle

Changing the guard

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From The Economist print edition

Reuters

What will a new secretary of state mean for American foreign policy and transatlantic relations?

AMERICA'S capital is split down the middle on the significance of Colin Powell's resignation as secretary of state and his replacement (subject to Senate confirmation) by Condoleezza Rice, the national security adviser. In the blue corner (as it were) are those who fear the change will mark an expansion of American hubris. The administration has lost its most powerful advocate for traditional moderate Republican internationalism, and can now be expected to stress its hard-edged, ideological hawkishness even more (if that were possible). This is the view—fear might be a better word—held by Democrats and many Europeans.

In the more optimistic red corner are those who think the change might provide an opening for renewed diplomacy. Both George Bush and Ms Rice, on this view, recognise that America's dismal image in the world is a problem and both want to repair frayed alliances. Mr Bush will travel to Europe soon after his inauguration. He also says he will do all he can to create a Palestinian state in his second term.

On balance, the red-corner optimists have the better argument, albeit with a proviso. Change in foreign policy is being driven more by facts on the ground than by any change of mind by the president and his foreign-adviser-in-chief.

It has to be admitted that there are plenty of reasons for scepticism about the possibility of greater engagement. Begin with the fact that Mr Powell has had more impact on the administration than many of his critics admit. America's relationship with China, for example, owes much to the outgoing secretary. In 2001, Mr Powell urged caution when China forced down an American spy plane in Chinese airspace. The administration's measured response paved the way for the current smooth relationship. The implication is that Mr Powell's achievements could be frittered away without his good counsel.

Moreover, Mr Bush could have nominated a more Powellite figure to the post than Ms Rice. In John Danforth, a former senator who is now America's ambassador to the United Nations, or in Bob Zoellick, the trade representative, the president could have found someone in the multilateralist Powell mould, had he wanted to do so. He might even, diplomatic scuttlebutt has it, have persuaded Mr Powell to stay on for a while.

In spurning such options, argue the pessimists, Mr Bush has abandoned any pretence that, in formulating foreign policy, he seeks a variety of options and then, like an efficiently impartial chief executive, picks and chooses. Instead, Ms Rice's nomination acknowledges the truth: that, for four years, foreign policy has been mostly run by a cabal of like-minded conservatives, who will now hear even fewer dissenting opinions.

Indeed, some diplomats and foreign-policy wonks fear Ms Rice's move will shift the balance of power inside that cabal towards its most hawkish members. While Ms Rice was at the National Security Council, the theory goes, she was the swing vote between Mr Powell on one side and Dick Cheney, the vice-president, and Donald Rumsfeld, the defence secretary, on the other. Most of the time she sided with the hawks, but not always.

Now that Ms Rice is in Foggy Bottom, and her deputy, Stephen Hadley, has taken over a probably less-influential NSC, the super-hawks will swoop. Unlike Mr Powell, Ms Rice will not try to be a counterweight to Messrs Cheney and Rumsfeld. As national security adviser, she was rarely able to rein in these two champion bureaucratic street fighters and they will duly come to dominate foreign policy in the second term. In short, Mr Powell's removal will mark a hard right turn for an administration not known for emollience.

Perhaps. But the reasons for doubting this view are more persuasive. Ms Rice's influence in the administration is not institutional, like Mr Rumsfeld's. It is not rooted in a wealth of experience, like Mr Cheney's. It comes from having the president's ear, and trust. There is some risk that this influence could be diluted by distance. She will not, after all, be inside the White House, seeing the president every day.

Still, her personal connection with the arbiter of policy—what her friends call the “mind meld” between herself and the president—will remain. And since her deputy is taking over the NSC, she may even have a little more influence in the second term than in the first, combining, as she will, a personal connection with the president with institutional power at State and some residual sway over the NSC.

Ms Rice is no ideologue. By background, she is a hard-edged realist, a believer in the uses of American power and the importance of great-power relations. This puts her at odds with those in the administration who see no point in diplomatic charm offensives. She may have a purely instrumental view of diplomacy, but at least she thinks it has a role. Her nomination is no neo-conservative grab at every lever in the foreign-policy machine.

The three uncertainties

Nor is it clear that the removal of Mr Powell really changes anything much within the administration. Though he had some successes, they were confined to bilateral ties (China and India come to mind). But on the broader issues of the war on terror and the particular case of Iraq, he had little influence. When he did make a difference—such as persuading Mr Bush to seek a second UN resolution on Iraq—it ended in failure. The truth is that the State Department under Mr Powell was marginal, not a competing centre of power.

Indeed, his replacement by Ms Rice may actually improve the prospects for diplomacy by bringing greater certainty to proceedings. Foreigners liked Mr Powell. But there was always a chance that what he said would be disavowed by the president 48 hours later—as when he famously admitted that he had “got a little too far forward on my skis” in saying the administration would pick up with North Korea where Bill Clinton had left off. Ms Rice, by contrast, has the president's ear.

All that said, three big uncertainties loom over the Rice State Department. The first concerns the new secretary herself. For four years, Ms Rice has been a sounding board, tutor and weathervane. She will now have to articulate a clearer view of the post-al-Qaeda world. For example: she has a lot of expertise in Russia (her academic speciality was the Soviet army). But should America's attitude to Vladimir Putin's centralisation of power be determined by the need to keep good relations with a partner in the war on terror? Or should it be influenced more by Mr Bush's view that the best way to starve global terrorism is to encourage democracy?

The second uncertainty concerns her department. Does she spend time reshaping it, replacing the diplomats in charge of North Korea and the Middle East (say), while risking the sort of hostility and disruption that Porter Goss is encountering at the Central Intelligence Agency (see article)? Or does she—

as James Baker did—bypass the diplomats, isolate the 7th floor of the State Department (where the secretary sits) and work around the bureaucracy? One measure of which route she intends to take will be her choice to succeed Mr Powell's loyal lieutenant, Richard Armitage, who also resigned this week. If she picks John Bolton, the punchy undersecretary for arms control, that would be a signal she intends to try to mould the department, not circumvent it.

But the big imponderable is how much appetite there is on both sides of the Atlantic for real diplomatic engagement. Even before the election, Mr Bush and Ms Rice privately indicated that, having got through three roller-coaster years after September 11th, it was time to patch things up in Europe and the Middle East—if only because diplomatic failure there could threaten what the president sees as his achievements in the war on terror. Even the most censorious of European governments know they must find a way to deal with the re-elected Bush administration.

But the fact remains that the three big “Is” dividing Europe and America—Israel, Iraq and Iran—are all hard to solve and easy to disagree about. At the moment, circumstances in all three (the death of Yasser Arafat, Iran's apparent nuclear concession, the prospect of Iraqi elections) are driving Europe and America together in a benevolent way. They are doing so at a time when Ms Rice's appointment opens up some possibility of greater diplomatic engagement. But there has been an overlap of interests, not a meeting of minds.

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About sponsorship

An intelligence shake-up

Spies thrown out in the cold

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The CIA's new boss takes out his broom

TWO MONTHS ago, Porter Goss, a seasoned Republican congressman and former spy, took charge of the Central Intelligence Agency. His task was to sort out an organisation that has been accused of several huge failures, including a collective failure to foresee the September 2001 terrorist attacks and a collective hallucination about Iraq's weapons of mass destruction. As chairman of the House Intelligence Committee, Mr Goss had called the CIA “dysfunctional”. As the agency's new head, he said he would have to get rid of much rotten wood. No surprise that Mr Goss is hard at work with his axe.

Over the past week, four senior members of the agency resigned, not all of their own free will. One of them, its acting chief before Mr Goss arrived, John McLaughlin, had been expected to hang up his magnifying glass after 32 years of service. But Stephen Kappes, the chief of secret operations, and his deputy, Michael Sulick, appear to have been forced out.

Predictably, this has caused resentment in the agency. Mr Goss's political past had already invited dark muttering against him. This week the muttering increased. The four close aides he brought with him from Capitol Hill have generated even louder indignation among CIA loyalists. The top one, Patrick Murray, has been accused of bullying. It appears that Mr Kappes tendered his resignation in response to Mr Murray's suggestion that he should sack his deputy. Mr Kappes was asked to change his mind. But then it turned out that his replacement had already been lined up.

That the CIA's corridors need a good sweep is not in doubt. At the publication of a recent report by the Senate Intelligence Committee, Senator Pat Roberts said that America's various intelligence organisations, not least the CIA, suffered from a “broken corporate culture and poor management”. The agency's bungles stretch way back. It failed to detect India's plan to test a nuclear bomb in 1998. The break-up of the Soviet Union, despite years of seismic creaking, was another big surprise to it. So Mr Goss's vigour has also brought applause. “If this were a company, you'd see a rise in the stock,” says Richard Perle, a former Defence Department official.

There is another reason for the Bush administration to look sternly at the CIA. Before this month's presidential election, some senior members of the agency appeared to be offering rather too muscular support to John Kerry. This included a series of leaks, not least about warnings the CIA had quite properly sent to Mr Bush before the Iraq war about its possibly dangerous consequences. One member of the agency, Michael Scheuer, even wrote an anonymous book entitled “Imperial Hubris”, castigating Mr Bush's foreign policy. He too resigned last week.

But repairing the CIA needs more than settling a few old scores. With two-thirds of the agency's staff congregated at its headquarters in Langley, there has emerged a complacent culture of “group-think”, as the Senate Intelligence Committee called it. Mesmerised by the attractions of high-tech espionage, the agency has neglected the bread-and-butter sort: getting spies dug into sensitive places. It did not have a single agent in pre-war Iraq. Mr Goss has promised to correct this, increasing the number of men in the field and cutting the bureaucracy. But this, his side says, requires a few top-level heads to roll.

If roll they must, it will not be without a fight. Officers of the CIA have resumed their whispering to newspapers. Mr Goss's choice for the agency's third-in-command was overruled after the *Washington Post* had been told an embarrassing story about his past. In tussles between the clandestine and political worlds, the spooks often have a lot of stuff to leak.

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After the election (1)

He said, she said, nobody knew

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The first of two pieces looking back at the mechanics of the election assesses the pollsters' performance

FOUR years ago, misled by the exit polls, America's television networks predicted and unpredicted the result half a dozen times. In 2004, after spending millions on a new system, the exit polls were wrong again, in a brand new way. Early on polling day, they showed John Kerry with a commanding lead. To misquote Lady Bracknell, to mess up one election may be considered a misfortune. To muck up two looks like carelessness.

Polling is in trouble, and not just exit polling. More voters are refusing to answer pollsters' questions. Representative samples of the population are harder to come by. Pollsters cannot properly survey the increasing numbers of people who use mobile phones or the internet. “Some pundits”, says John Zogby, a pollster, “are ready to declare that polls are dead.”

Pollsters do face serious problems, but imminent death is not one of them. In fact, this year's election has bought them a few more years of life. The average of polls in the final days of the campaign was remarkably accurate: it showed George Bush getting 50% of the vote to John Kerry's 48.5% (the final tally was 51% to 48.1%). If anything, the polls have been victims of their own success. Every news outlet now seems to have its own pollster. This almost certainly improves the polling average, but it also means that, at any one time, there will be a couple of misleading outliers.

So why the doom-saying? Several technical problems bedevil polls. The most worrying is the decline in the response rate. In 1997, according to the Pew Research Centre, a typical poll conducted over five days would get responses from 36% of households; in 2003 the rate was 27%.

The decline has not yet undermined the validity of polls—as the accuracy of the final surveys suggests. Pew ran a control experiment comparing a typical poll with one lasting five months. The results were almost the same, even though the long-lasting survey had a much higher response rate (51%). At some point, presumably, the rate will dip below a critical level and results could go haywire. But that has not happened yet. The “extra” respondents you get from a big poll seem to be no different from those who answer a typical one.

But what if those who refuse to answer come disproportionately from one group? Warren Mitofsky, one of the designers of this year's exit polls, suggests that just such a “differential refusal” skewed his results. “We suspect”, he told PBS's NewsHour, “that the main reason was that the Kerry voters were more anxious to participate in our exit polls than the Bush voters.”

This would be the first time a group of non-responders was different enough from the average to have an impact. But the evidence is patchy. Earlier in the campaign, pollsters worried that Bush supporters were more likely to answer questions than Kerry ones. “Refusal bias” is a growing problem. But it is not clear how serious it is right now.

That is also true of the “cell-phone” difficulty. By law, Americans pollsters may not contact mobile telephones, so they missed the 7% of voters who said they used only these. That is not a large or distinctive enough group to skew the polls. But the figure rises to nearly 20% among voters below the age of 30. Over time, they could become a big enough share of the electorate to make a difference.

That is for the future. In this election, the biggest polling problem was how to identify likely voters. Because turnout in America is below 60%, pollsters adjust their raw numbers to screen out people deemed unlikely to vote and also to ensure that their sample properly represents ethnic minorities,

women, registered Democrats and Republicans, and so on.

The trouble is that, by reducing the size of the sample, screening produced implausible volatility in the middle of the campaign. Frequently, half the polls would show Mr Bush's vote rising while the other half showed it falling. Jon Krosnick of Stanford University also points out that screening produced an illusory "bounce" after each convention. The screen let through a disproportionate number of Democrats after the Democratic convention, and Republicans after the Republican one. But no one had really changed their minds.

On the other hand, not having a tough enough screen can be worse than having one. And here *The Economist* has to own up to problems of our own. YouGov, a firm that has used internet polling successfully in Britain and Australia, polled for us in America without sufficiently seeking to gauge respondents' likelihood to vote. Its final poll showed Mr Kerry up by three points among registered voters. Interestingly, YouGov says that if you recalibrate its final poll to reflect the demography of the voters who actually showed up on November 2nd, its panel showed a Bush lead (fewer blacks and poor people actually voted than YouGov researchers expected).

Are there better ways to find likely voters? Andy Kohut at Pew argues that traditional techniques—in which you decide in advance the demographic features of your sample and include only a predetermined share of likely voters—work less well than so-called "database techniques". The latter use computer programmes to adjust the sample based on the actual responses.

Polling is here to stay. In a country the size of America, it is the only way to bring cohesion to a mass of anecdotal evidence. But it needs to be taken—early in the campaign, especially—with the proverbial pinch of salt.

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After the election (2)

Money, politics and more money

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The McCain-Feingold reforms come through their first test

AP

Gentlemanly stuff, really

TWO YEARS ago, George Bush rather grumpily signed the Bipartisan Campaign Reform Act. Better known as “McCain-Feingold” after its senatorial sponsors, John and Russ, the bill was supposed to reform money politics. The effect? American politicians spent a colossal $4 billion for this year's presidential and congressional races—a third more than was spent in the 2000 election.

Big spending was not a guarantee of victory. In the presidential race, Mr Bush outspent John Kerry by around $65m, but, once you add in spending by third-party Bush-bashing groups (George Soros alone spent $27m on such causes), Mr Kerry may actually have had the superior firepower. In the Senate's most expensive race, Tom Daschle spent $7m more than his Republican challenger, John Thune, in South Dakota—but he still lost.

Yet, all in all, big spenders tended to win. In eight out of ten races for open seats in the House and in nine of ten open Senate races, the winners outspent their rivals. Incumbents, more than 90% of whom were re-elected in both houses, enjoyed a huge fund-raising edge: in New York, Senator Chuck Schumer, who already had a $16m war-chest, added another $11m, even though he had a safe seat.

Does this mean that McCain-Feingold failed? Surprisingly, no. The success rate for incumbents in the House surely had more to do with gerrymandered redistricting than money. More fundamentally, McCain-Feingold's aim was never to get money out of politics (for better or worse, that remains a minority point of view in America); it was to make it harder for big donors to wield influence over politicians.

The bill basically did three things. It banned “soft” money (unlimited cash given to parties, not individual campaigns, supposedly for party building) while simultaneously raising contribution limits for “hard” money (given directly to candidates and the parties) from $1,000 to $2,000. It prohibited unions and other organisations from running “issue ads” (usually thinly disguised attacks on individual candidates) within 60 days of the general election and 30 days of a primary. And it required candidates clearly to authorise their ads, giving them a disincentive to launch spurious attacks.

When McCain-Feingold was passed, its critics claimed it would endanger free speech (giving money, they claim, is protected under the free-speech part of the constitution). In fact, both parties amassed more hard dollars for this election than they did in soft and hard money combined in 2000. Thanks to the new law, political fundraising became far more broad-based, with individual contributions to parties and

candidates jumping from $1.5 billion in 2000 to roughly $2.5 billion this year. The proportion of donations coming from people who gave $200 or less shot up from 10% in 2000 to nearly a third. The Kerry campaign raised over $80m in donations through its website.

On the other hand, corporate giving all but dried up. Companies were happy to be banned from making soft-money donations. Trade unions found they got more bang for their buck by organising get-out-and-vote drives among their members than by broadcasting ill-timed issue ads.

There were two big exceptions to this rosier picture. The first were the “527” organisations patronised by the likes of Mr Soros. These allegedly independent organisations (named after a provision in the tax code) amassed an impressive $470m, much of it from rich individuals. Some 46 wealthy people gave more than $1m each. Some of the 527s were genuinely independent, but by any normal definition, many were not: the Democrats in effect contracted out a lot of their organisation to groups like America Coming Together, and the Republicans had close ties to the Kerry-bashing Swift Boat Veterans for Truth.

Mr McCain blames the Federal Election Commission (FEC) for not administering the law toughly enough. A 1976 Supreme Court decision says that groups whose “major purpose” is to influence federal elections must register with the FEC as “political committees”. Mr McCain will push legislation in Congress's upcoming session that will require all such 527s to do this, thereby making them submit to the hard-money rules. He has also pledged to shut down the FEC. But can he get these things past his fellow Republicans, many of whom would rather scrap McCain-Feingold than reform it?

The other problem has to do with the system of providing public money for presidential candidates during the primaries. This was supposed to even things up and help the challengers. But the state's cash comes with too many strings—principally a limit on how much the candidate can raise. Mr Kerry, like Mr Bush, rejected the offer. That saved taxpayers' money, but it made the two main candidates even more dependent on “bundlers”, the fund-raisers who specialise in racking up hundreds of $2,000 contributions.

Here, changing the law may be easier, at least at the presidential level. But an anomaly remains: there is no public money to help challengers in congressional races. Strangely, there is little chance of sitting congressmen and senators altering the rules to help the upstarts.

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Churches and politics

The religious left

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Well, it does exist—but not in an organised way

THE next time you are in Minneapolis, you may like to visit St Joan of Arc church. Its weekend masses are packed; the congregation has doubled to 4,000 households in the past 12 years; the median age of its members is much lower than that of most other churches. It sends do-gooders to a sister parish in Guatemala, and professional musicians often stop by to jam at mass. This liberal Roman Catholic church hit a bump recently when conservative critics complained to Rome about some of its practices, including an open door for homosexuals. The bishop tried to intervene, but met a wall of protest from parishioners. St Joan's pastor, Father George Wertin, says that he is mindful of the church's teaching, but remains committed to inclusiveness and social justice.

There has been much hand-wringing among liberals about the growing influence of conservative Christians, particularly since so many voters cited moral values as a key reason for re-electing George Bush on November 2nd. But there is a religious left in America, too; and some of its leading members want a louder voice.

“We intend to be as articulate and aggressive as our evangelical counterparts,” says Bob Edgar, a former Democratic congressman from Pennsylvania who leads the National Council of Churches (NCC). The country's largest ecumenical group, representing 36 Protestant, Episcopalian and Orthodox denominations with a total of about 50m members, the NCC was a force for change in the 1960s and 1970s, but has seen its influence wane since then. Now Mr Edgar, himself a minister, says that it seeks a renewed discussion of “public values” like poverty and war, not just the “private piety” of abortion and homosexual marriage. “When Jesus met the woman at the well, he didn't ask her sexual orientation. He loved her.”

Not everyone is convinced of this approach. Jean Bethke Elshtain, of the University of Chicago's divinity school argues that focusing on “nitty-gritty” issues like poverty and war is a hard sell. “No one wants poverty, but there are so many proposals to deal with these intractable social problems.” She worries that the clergy is more liberal than its parishioners are.

First breed, then retain

Numbers are on the conservatives' side. Data compiled by the NCC show that at least half of Americans go to religious services once a week or more. Within that number, the Roman Catholic church, reinforced by immigrants, has seen its numbers rise. So have the generally conservative evangelical, Pentecostal and Mormon churches. The more moderate Episcopalians and “mainline” Protestant groups such as Methodists and Presbyterians, continue their long decline, albeit more slowly in recent years.

Few churches are undivided in their ideas: consider the Episcopalians' ructions about the appointment of an openly homosexual bishop. But the trend has been to the right. A survey several years ago of more than 1,200 congregations in America reported that nearly 60% of the clergy described their congregations as theologically conservative, compared with 29% moderate and 11% liberal. The congregations of most of the new megachurches that have sprung up across the suburbs in the west and South are conservative. Slower-growing New England had the largest proportion of liberal churches.

Mike Hout, a sociologist at the University of California at Berkeley, points to two things favouring conservative churches: demography and “retention”. The softer sort of Protestants have not been breeding as prodigiously as evangelicals have. Moreover, conservative churchgoers are more likely to keep their children in the flock: as many as 85% of the children of evangelicals become adult members

of similar churches, whereas liberal Christians are a good deal more likely to lose their children to secularism. The Presbyterians, good for them, have now “closed the retention gap”.

What passes for the religious left still patently lacks the organisation of the right. Divinity students at the University of Chicago launched a website (thereligiousleft.blogspot.com) days after the election, and gathered for their first meeting this week. Protestants for the Common Good, formed in 1995 to counter the impact of the religious right, has an overtly leftish agenda. Larry Greenfield, an ordained Baptist minister who works with the group, sees growing “re-engagement” that he hopes will match the civil-rights and Vietnam-war struggles of the 1960s.

Mixing religion and politics, of course, can be a nasty business. Safety precautions had to be taken at Presbyterian churches across America this week after a threat that churches would be burned if an “anti-Israel” policy was not reversed—an apparent reference to the church's decision some months ago to divest itself of companies doing business in Israel.

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Black home-owners

Single black female, in her own house

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A good story to tell, as long as the market stays healthy

THE church billboard overlooking Interstate-20 in DeKalb County offers you a “New Life”. It could just as well be talking about the property market in this mainly black area east of Atlanta. The number of black home-owners in Atlanta nearly doubled during the 1990s, and is still rising. South DeKalb, the poorest part of the county, has seen its population grow by 40% over the past decade, much of it in small apartments. The economy in general is brighter: the parking lot at South DeKalb Mall soon gets filled up.

Until recently, most home-seekers in Atlanta have looked to the white northern suburbs. But mostly black South Fulton County saw three times as many home sales last year as in 2000. Clayton County, farther south, is now 68% black, up from 62% in 2000, partly because it has lots of affordable family homes.

Atlanta has long had a reputation as a centre of black-owned commerce, and as the home of two of the most respected black colleges in the country. But much of the new home-buying took place while the city was in an economic slump, from which it has begun to recover only in the past six months.

There is also good news for the female sex. A third of the new home-owners are unmarried black women. Atlanta, a city in which there are about 100,000 more single black women than black men, saw the number of mortgage loans to unmarried black women jump by 114% from 1997 to 2002.

Two recent reports suggest that the growth of black home-ownership in Atlanta is part of a nationwide trend. Harvard University's Joint Centre for Housing Studies, in its most recent annual report, notes that 48% of blacks owned their homes last year—compared with 42% a decade earlier. The home-ownership rate for Latinos also jumped by a similar margin. Non-whites are buying older houses (usually the posher sort) and then smartening them up: in just one year these people spent $37.8 billion on housing renovations.

The growth in home-ownership both drives and feeds off continued gains in wealth. The University of Georgia's Selig Centre for Economic Growth says that black buying power has increased steadily across the country, from $318 billion in 1990 to $723 billion in 2004 and a projected $965 billion in 2009. At a time when every American seems to be paying for his credit-card debts with home-equity loans, blacks have (for better or worse) joined the party, helped partly by the fact that many mortgage firms now rely more on colour-blind computers than on sniffy clerks to check up on applicants.

This does not mean that the picture is entirely rosy. Even the richer black buyers are likely to have to pay stiffer interest rates than their white equivalents. And some people worry that the surge in single black women home-owners could also have an ugly ending. They already spend a higher proportion of their income on housing than their married and male counterparts. A housing crash would be particularly bad for them.

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Lexington

The fear myth

Nov 18th 2004
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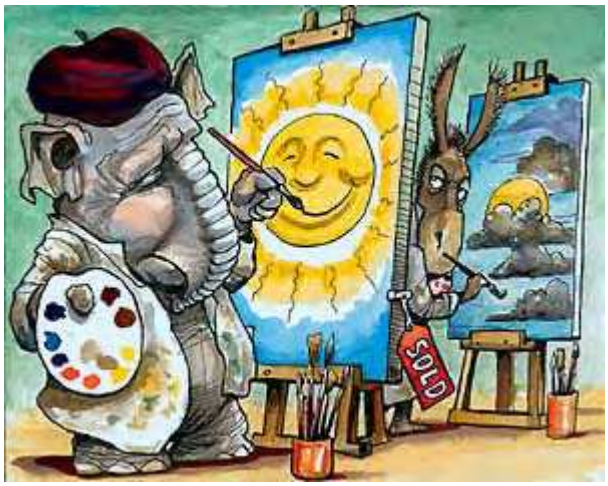

Actually, George Bush's victory had more to do with hope and growth

IN THE past fortnight, the Democrats have come up with lots of comfort-food explanations of George Bush's victory—from the idea that the rascal stole the election for a second time (there were a mere 3.3m votes in it, after all) to the notion that he rode into Washington, DC, at the head of an army of hooded fundamentalists. But perhaps the most dangerous of all these myths is the idea that Mr Bush terrified the voters into re-electing him. He divided the country along "fault lines of fear", according to Maureen Dowd in the *New York Times*; he relied on "fear of and hatred for modernity", added Garry Wills, polymath and devout Catholic. Sooner or later every Democrat starts saying that the president used terrorism to partisan advantage.

This explanation is dangerous because it contains a measure of truth. The election certainly took place against a background of fear (Islamic fanatics are, after all, bent on killing as many Americans as they can). And the Republicans certainly played the fear card with gusto (as indeed did the Democrats: remember all the talk about reintroducing conscription). But if they are going to extract any useful lessons from their humiliation, the Democrats need to realise that the Republicans didn't just beat them on fear. They clobbered them on hope.

For the moment, the American right is better at talking about the future than the left. It is better at exuding optimism. And it is better at addressing the aspirations of an aspirational people.

Arguably the only optimistic thing about the Kerry campaign was its slogan: "Help is on the way". In general, the Democrats focused on America's intractable problems. By contrast, Mr Bush not only sounded upbeat, but also came up with solutions, of sorts. At home, John Kerry was happy to cast himself as the blind defender of a 70-year-old Social Security system that is headed for bankruptcy; Mr Bush talked about using privatisation to shore up the "ownership society". Abroad, the president even managed to sound optimistic about terrorism, promising to drain the swamp of terrorism by spreading democracy.

Mr Bush's optimistic message gave him a commanding advantage in pro-growth America. Joel Kotkin, a Los Angeles-based writer who knows as much about the grassroots economy as anyone, points to the close relationship between growth, both demographic and economic, and a propensity to vote Republican. Most of Mr Kerry's base was in stagnant America. Democratic strongholds such as Chicago, Cleveland, San Francisco and Mr Kerry's Boston have been losing people and jobs.

Mr Bush's America, for the most part, is booming. This is not just because the red states that voted for Mr Bush are growing faster than the blue states that voted for Mr Kerry. It is also because Mr Bush did well in the fast-growing suburbs and “exurbs” in both red and blue states. Mr Bush's triumph in greater Phoenix, greater Houston and greater Atlanta was perhaps predictable. But Mr Kotkin points out that he also triumphed in what he calls the “third California”: the vast inland region that is producing the bulk of the state's growth at the moment.

How have the Republicans succeeded in turning themselves into the party of the future? One answer is that they have been better at reinventing themselves. Over the past quarter of a century, both parties have made concerted attempts to adjust to a period of radical social change—the Republicans under Ronald Reagan in the 1980s and the Democrats under Bill Clinton in the 1990s. But the Republicans have more or less stuck with the Reaganite revolution. The Democrats, on the other hand, have all but forgotten the lessons of Clintonism.

Back in 2000, Al Gore tried to revive southern populism with his talk of fighting for “the people against the powerful”. (“There aren't many Tom Joads in the exurbs,” says Marshall Wittmann of the Democratic Leadership Council. “If you're fighting for anything, it's probably a parking space.”) Mr Kerry lambasted “Benedict Arnold corporations”. Having built a bridge to the 21st century under Mr Clinton, the Democrats have since been busy building another one back to the 19th century.

There are plenty of short-term excuses for this. The Lewinsky affair persuaded Mr Gore that he needed to rebrand his party. The Howard Dean insurgency made Mr Kerry focus on Bush-bashing. But what is worrying for the Democrats is that there may be two bigger forces turning them into a party of the past.

The no-need-to-change-things party

First, the party is increasingly dominated by people who have no yearning for growth: public-sector workers; academics and trustafarians who both live off inherited endowments; environmentalists who want to regulate SUVs and urban sprawl; and billionaires who are too rich to aspire to anything. (One of the best statistics of the campaign is that people worth $1m-10m supported Mr Bush by a 63-37% margin, whereas those worth more than $10m favoured Mr Kerry 59-41%.)

Second, the Democratic Party is ceasing to be a mom-and-pop party. Phillip Longman of the New America Foundation points out that the fertility rate in the Kerry states is 12% lower than in the Bush states. Vermont, the home of Howard Dean and perhaps the most left-wing state in the country, produces an annual average of 49 children for every 1,000 women of child-bearing age; in Utah, where 71% of the population voted for Mr Bush, the figure is 91. In deep-blue cities such as San Francisco and Seattle you find more dogs than children.

The Democrats are not beyond redemption. Mr Clinton showed they can triumph in the suburbs by preaching economic growth and social responsibility. But they must abandon all this comforting claptrap about fear being Mr Bush's friend—and start to focus on the much more devastating truth. In America, self-styled progressives look ever more the party of the past, and confessed conservatives are the ones focusing on the future.

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Latin America and the United States

Picking up the pieces

Nov 18th 2004 | MEXICO CITY AND SÃO PAULO
From The Economist print edition

What can Latin America expect of a re-elected George Bush?

FOR the people who count in Washington, DC, Latin America is an afterthought. There are some exceptions. Mexico matters, because it is part of the North American Free-Trade Agreement (NAFTA) and a big source of immigration. So do war-torn, drug-soaked Colombia and Communist Cuba. But, for the most part, the region “is not relevant to the strategic interests of the US,” says Rubens Barbosa, a former Brazilian ambassador to Washington, now a consultant in São Paulo. The “main focus is economic.”

So it is a mild shock that George Bush's first foreign trip after his re-election will be to Chile, which had planned to vote against the abortive UN Security Council resolution authorising war in Iraq. The main event is the summit of the Asia-Pacific Economic Co-operation group, but Mr Bush also plans an official call on Chile's president, Ricardo Lagos, and a stop in Colombia on his way back. This is a signal of American goodwill toward Latin America. It does not portend greater commitment.

The United States' headline initiative is grand enough: a “Free-Trade Area of the Americas” (FTAA) encompassing all 34 democracies of the western hemisphere. Yet it is sputtering. The January 2005 deadline is sure to come and go. The United States wants more protection for investors and intellectual property than Mercosur, a four-nation grouping including Brazil, is willing to yield; Mercosur had wanted the FTAA to deal with agricultural subsidies, which the United States has reserved for the multilateral Doha talks. The main promoter of the FTAA in Washington, Robert Zoellick, the trade representative, may follow Colin Powell out of the door.

Attention has therefore shifted, both to Doha and to bilateral trade deals between the United States and other Latin American groupings. These include Central America—the respective governments recently signed a free-trade treaty—and the Andean countries.

But success on any of these fronts depends on the United States Congress, which has yet to ratify the Central America treaty, and is in protectionist mood. States that gave Mr Bush his victory get the most agricultural subsidies, points out Riordan Roett, of the Johns Hopkins School of Advanced International Studies. That is especially bad news for Mercosur, an agricultural superpower, which is one of the few areas in the region not actively negotiating a bilateral trade agreement with the United States. Non-ratification would also severely disappoint Central America's leaders, who backed Mr Bush wholeheartedly

over Iraq—three of them even sent troops there—in the belief that John Kerry might sink the free-trade deal.

Yet after a period of testiness, Brazil and the United States have been co-operating to relaunch the Doha talks. Even without any trade deals, Mr Barbosa expects trade between the United States and Brazil to "at least double" to $60 billion within the next ten years. Their relationship is "excellent, despite all the frictions," he says.

One of the grumpiest countries, in fact, is probably America's next-door neighbour. Never keen on the FTAA—it has its own sweet trade terms thanks to NAFTA—Mexico had high hopes of Mr Bush, raised by his apparent bonding with his ranch-owning, horse-riding counterpart, Vicente Fox. But its biggest wish, an immigration accord for free (or at least easier) movement of labour, got stuck after the September 11th attacks. Mr Fox also offered no help on Iraq, and relations have been slow to recover. Many Mexicans saw a guest-worker plan that Mr Bush outlined last January, which went part of the way towards meeting Mexican ambitions, as little more than an election ploy aimed at Hispanic-American voters.

Yet for the most part, relations overall between the United States and Latin America are surprisingly cordial. To be sure, most leaders in the region abhor Mr Bush's unilateralism, and his buddy list got shorter last month with the election of Tabaré Vázquez, a leftist, to the presidency of Uruguay. Yet many leaders, including Brazil's Luiz Inácio Lula da Silva, are thought to have rooted privately for his re-election, fearing that John Kerry would be more protectionist. And Mr Bush seems to appreciate that leftists who are committed to democracy and responsible economics, such as Lula and Mr Vázquez, are good for regional stability.

That stability is not assured. Order has collapsed in Haiti, Venezuela is governed by a populist with authoritarian tendencies, Bolivia's next president may be a similar character and the governments of Ecuador and Peru are shaky. The "biggest policy challenge" for the United States is countries that could "go completely off track," says Miguel Diaz of the Centre for Strategic and International Studies in Washington. Lula has been a particular help in such areas, sending his army to lead a multinational force in Haiti and pressing Venezuela's president, Hugo Chávez, to adhere to the constitution in his bid to hold on to power.

Yet Mr Bush's trip to the region addresses stability in only a limited way. His state visit to Chile bolsters it as the region's model of good economics, transparency and the rule of law (see article). His stop in Colombia is a nod to the over $3 billion that the United States has ploughed into fighting drug production and insurgency there. The rest of the region will have to remain content for now with symbolism and selective trade concessions.

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Argentina's president

Non-stick Néstor

Nov 18th 2004 | BUENOS AIRES
From The Economist print edition

Corruption allegations are sliding off, for now

LESS than three years ago, Argentine politicians could not venture on to the streets without receiving insults—or worse—from a population that had despaired of misgovernment. By contrast, since he took office as president in May last year, Néstor Kirchner's public walkabouts have become the stuff of legend. Eschewing protocol, he has repeatedly launched himself into largely adoring crowds.

But his image of probity is now coming under siege. The government last month trumpeted a report by KPMG, an international consultancy, showing a dramatic fall in corruption as perceived by businesses. Yet just days later the annual perceptions index from Transparency International, an anti-corruption crusader, ranked Argentina joint 108th out of 146 countries for honesty, scoring just 2.5 points out of ten—the same score as the previous year.

Sensing weakness, the opposition has gone on the attack. In particular, it accuses the government of using its considerable advertising budget to manipulate the media. There was a scandal this month when *Página/12*, a leftist daily sympathetic to the president, spiked an article by a columnist alleging government corruption. The circulation and then squashing of rumours that Mr Kirchner would announce spectacular Chinese investments in Argentina raised fresh suspicions that the powers-that-be were playing games with the press. Visiting Buenos Aires this week, China's president announced plans to invest nearly $20 billion over the next decade, but no hard commitments.

Nevertheless, this still looks like little worse than a ham-fisted attempt at spin. Far more damaging to Mr Kirchner's reputation would be solid evidence of corruption. That, however, is lacking. Elisa Carrió, a messianic opposition leader, accuses Mr Kirchner of doing favours for a local company in return for campaign financing, a charge he roundly denies. The president is attacked for temporarily transferring over $500m abroad when he ran Santa Cruz province, to avoid a bank deposit freeze. But the opposition has not substantiated claims that money was misappropriated. And, ironically, his critics owe much of their ammunition to a freedom-of-information decree.

Mr Kirchner's supporters, meanwhile, shower him with praise for clearing out discredited Supreme Court judges and introducing a transparent mechanism for choosing replacements. But he has undoubtedly made some poor calls, such as appointing the unqualified wife of a minister to head an anti-corruption audit office. And whatever the truth about the finances of Santa Cruz, he has done too little to rebut those charges.

For now, public opinion somewhat favours the president. Although almost half the population rates the government negatively on corruption and transparency, that is far better than any of his recent predecessors, according to Graciela Römer, a pollster. But Mr Kirchner needs to avoid complacency. Ms Römer says that demands for transparency tend to surface at times of economic crisis. For now, the government has been bolstered by sustained growth. But if that falters and he has not dispelled the doubts, the president may find the public readier to heed his opponents' accusations of dishonesty.

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Chile and APEC

Selling points

Nov 18th 2004 | SANTIAGO
From The Economist print edition

The APEC summit is a chance for Chile to prove itself

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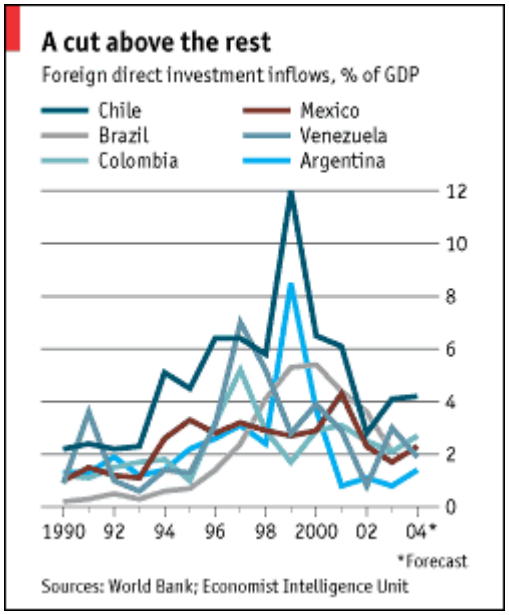

FOR Chile, a small economy driven by exports, international integration is a keystone of growth. And by hosting the 12th annual Asia-Pacific Economic Co-operation (APEC) summit from November 19th to 21st, it hopes both to tighten its trade ties with Asia and to sell itself as a platform from which foreign investors can do business in South America.

Having recently negotiated free-trade agreements with the European Union and the United States, Chile now has Asia in its sights. A trade deal with South Korea—the latter's first ever—has been in place since April, and it is in tripartite talks with New Zealand and Singapore. Most significantly, Chile and China are expected to announce the launch of negotiations during the APEC meeting.

Japan and China are, after the United States, Chile's largest export markets. In the first nine months of this year, sales to Asia were up year-on-year by 64%. True, that owed much to the high price of copper, Chile's main export, but it is also now selling products like farmed salmon and wine.

However, Chile's interest in Asia goes beyond exports. It also sees itself as a potential “bridge” for trade and investment between Asia and other South American countries. As a continental trade port, admittedly, its future is dim: Chilean shippers say that they handle little traffic between Asia and Argentina or Brazil, and there has been only slow progress on building the road and rail links across the continent that could extend the hinterland of Chilean ports.

More importantly, Chile wants to promote itself as a platform from which foreign firms can do business in the region. Some companies, mostly North American and European, already do; the government hopes that more Asian ones will soon follow suit. Chile's many trade pacts give businesses based there zero- or low-tariff access to a market of almost 1.3 billion consumers, points out Karen Poniachik of the government's Foreign Investment Committee. And it has a more basic selling point—a reputation as a safe, stable and reliable country. That is what it will try to prove to the heads of state from Asia and the Pacific at its largest international meeting ever.

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Mexican local elections

PRItty pleased

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Mexico's former ruling party caps a successful electoral year

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AS MEXICO has so far failed to tidy up its electoral calendar, some years can end up as a seemingly endless merry-go-round of state and local elections. This year there have been 14 such elections; the final five were held on November 14th.

For analysts using the results to seek predictions for the 2006 presidential election, the year ends as it began. The Institutional Revolutionary Party (PRI) is continuing a startling comeback from its presidential defeat in 2000, which ended 71 years of one-party rule. The latest results give it two out of the four gubernatorial races being contested, in the states of Puebla and Tamaulipas. It will win the state of Sinaloa too if the final results confirm its hair-thin provisional victory; results are also pending in Mexico's smallest state, Tlaxcala, where the PRI is just behind the National Action Party (PAN) of Vicente Fox, the president. If the PAN wins, it will be one of its few consolations since losing badly in the mid-term congressional elections in June 2003.

That gives PRI supporters much to crow about. If it takes Sinaloa, the party will have retained all eight of its state governorships that were up for grabs this year. Furthermore, Sinaloa would repeat a trend in several states that the PRI has contested this year, where it has shown its ability to squeeze out narrow victories in highly competitive elections. This is a relatively new circumstance for a party that was accustomed to a virtual monopoly of power at all levels until the 1990s.

The PRI has also shown that it alone can win elections all over the country—unlike the left-of-centre Party of the Democratic Revolution (PRD). That did worst on November 14th, losing Tlaxcala by a big margin, and doing only indifferently in municipal elections in one of its strongholds, the Pacific state of Michoacán.

For Daniel Lund of MUND Americas, a polling firm, this shows that the PRD remains “totally inadequate” for supporting a presidential bid. The party will be in the odd position of having the strongest candidate for 2006—Mexico City's mayor, Andrés Manuel López Obrador—but the weakest national organisation. In contrast, the PRI is showing its national strength, even as its leader, Roberto Madrazo, remains comparatively unloved outside the party faithful. But the year's string of PRI victories will give him a good run at the party's presidential nomination.

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Vancouver's homeless

The mean streets of Arcadia

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From The Economist print edition

A growing problem is disfiguring Vancouver's golden reputation

MOST Vancouverites love it when, as frequently happens, their city gets rated as one of the nicest places in the world in which to live. But to its poorer residents such seals of approval can seem like a sick joke. Vancouver enjoys a beautiful sea-and-mountain setting and some increasingly ugly problems. The Downtown Eastside, a scene of battered and boarded-up buildings, is the most concentrated pocket of poverty and crime in Canada. Despite police crackdowns, an open drug bazaar still thrives on its street corners. Its back alleys, doorways and parks are home to a ragged, swelling tribe of homeless men, women and children.

Ten years ago this was a minor, largely invisible problem. Now, even in the poshest districts, citizens are daily confronted with panhandling, break-ins and theft. But it is the number of homeless that has particularly shocked the city. As Peter Ladner, a city councillor, says, “People don't like it, not because it's messy, but because it's a shameful thing.”

And it is getting shamefully worse. Vancouver's homelessness rate, though lower per person than in some of British Columbia's other cities, has doubled in the past three years: in summer up to 1,800 people are sleeping rough or in shelters, according to a plan presented this month by the city council's homelessness co-ordinator. Almost all the homeless are unemployed and about 75% are not eligible for or not getting welfare, so they survive by begging, scavenging and petty crime. Most suffer from drug or alcohol addiction, mental illness or both. A further 40,000 people, who spend more than half their income on housing, are “at risk” of homelessness. And almost 10,000 are on the waiting-list for subsidised housing.

Most critics blame British Columbia's “mean-spirited” Liberal government for social-service cuts in its three-year drive to eliminate its deficit. In more sober language, the city's “action plan” in effect does the same, documenting the provincial government's tightening of welfare access, cuts in subsidised housing and failure to provide services for the mentally ill. “To deal with a deficit crisis,” says Darrell Burnham, head of an agency helping the mentally ill, “they've created a long-term social crisis that won't be turned around in a year or two.”

Murray Coell, the provincial government's minister responsible for social housing, says it is already taking action. He cites the C$154.4m ($117.5m) this year for subsidised housing—though that is a mere C$1.1m more than the year before. Welfare for the disabled has risen by a slightly less stingy C$70 a month, or 8%. And, he says, the new Premier's Homelessness Task Force will next month unveil “a multifaceted, comprehensive, long-term strategy” to deal with homelessness, mental illness and drug addiction.

Sceptics accuse Gordon Campbell, the premier, of electioneering. “Six months before an election and all of a sudden he's going to address homelessness,” says Carole James, leader of the opposition New Democratic Party. But city and provincial leaders may have their eye on avoiding later embarrassments too: Vancouver (and the nearby Whistler resort) is due to host the Winter Olympics in 2010.

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China's development

String of pearls

Nov 18th 2004 | HONG KONG AND ZHONGSHAN
From The Economist print edition

If China's Pearl River Delta wants to retain its dynamism, it has to expand hugely

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WHAT would Sun Yat-sen, the father of modern China, make of his hometown today? Mostly, he would be proud. Zhongshan, in the heart of southern China's Pearl River Delta (PRD), exemplifies the rapid economic development of what has, over the past two decades, become the country's export powerhouse. Zhongshan's output grew by almost 18% last year, twice the national average, largely by attracting foreign investment. Still China's largest producer of light fittings, the city can also now boast that 20 *Fortune* 500 companies manufacture there. Annual urban incomes, at nearly 15,000 yuan ($1,800) per person, are twice the national average too. But Zhongshan also reflects the costs of rapid development. Smog blankets the city. Misdirected spending has resulted in five airports within 90km (60 miles), but no rail connection, while the planned superhighway that would link it to Macau and Guangzhou has not been built.

The PRD's difficulties are those of Zhongshan writ large. Transformed from a rural backwater into the world's workshop through Deng Xiaoping's economic reforms and the proximity of Hong Kong's capital, technology and business skills, the PRD, centred on Guangdong province, China's richest, is the world's largest supplier of everything from televisions to toys. But worsening pollution, infrastructure and power bottlenecks, severe labour shortages and rising wage costs are combining to take the edge off that success. The PRD is starting to lose investors to another of China's economic and political heavyweights—Shanghai and the Yangtze River Delta (YRD), which enjoys better access to China's huge domestic market.

This has prompted the region's politicians and businessmen to come up with a typically Chinese solution: to grow their way out of the problem by extending the PRD. The idea, first proposed in July last year by Zhang Dejiang, Communist Party secretary and hence the top official of Guangdong, is to create a “Pan-Pearl River Delta” that would extend regional co-operation in trade and investment from the south and east of the country to the centre and west. Also known as the “9+2”, it would link the nine provinces of Guangdong, Fujian, Jiangxi, Hunan, Guangxi, Hainan, Guizhou, Yunnan and Sichuan with the two special administrative regions of Hong Kong and Macau via a new web of road, rail and air routes. Simultaneously, trade and non-tariff barriers between the provinces would be eliminated to allow the PRD to develop new markets and free up the movement of labour.

With a population of 450m, roughly the same as the enlarged EU, and a gross domestic product of some

$630 billion, the 9+2 zone encompasses a fifth of China's land, a third of its people, produces one-third of the country's exports and almost 40% of its economic output.

Ambitious it may be. But Michael Enright, Sun Kai professor at the University of Hong Kong's School of Business and an expert on the PRD, thinks the plan will work—though it could take 30 years for China to become a single national market. The timing is good, given that under President Hu Jintao, China's leadership is emphasising the need to bring the dynamism of the coast to poorer central provinces. This means there should be strong support from Beijing.

It will certainly be needed, given competition from the YRD. While Guangdong's exports have doubled in the past five years to reach $153 billion in 2003, those of the Greater Shanghai region (including the nearby provinces of Zhejiang and Jiangsu) have almost quadrupled to catch up. In terms of foreign direct investment, Shanghai is already ahead, attracting $21 billion in FDI last year, against $7.8 billion for Guangdong. Shanghai has become the preferred site for technology firms and heavy industry.

True, there are still plenty of cheap places to manufacture in Guangdong. Henry Tan, chief executive of Luen Thai, Hong Kong's largest garment business with 20,000 employees, says he can save a third in power costs and half in wage bills just by relocating a factory half an hour's drive from Guangzhou, the capital of Guangdong. And as low-margin exporters leave the region, the province is starting to move up the value chain. Guangzhou is becoming the Chinese hub for Japanese carmakers, including Honda and Toyota, which are drawing in support industries like steelmakers and auto parts suppliers. Meanwhile Shell is building a huge petrochemical complex in the area to serve factories with basic materials like plastics, which they currently have to import. A 20m-strong middle class is demanding services from car finance to better health care and education.

But to upgrade an economy based on light manufacturing with the speed and on the scale required means developing a hinterland, just as Shanghai has done. Victor Fung, chairman of the Greater Pearl River Delta Business Council, sees the 9+2 region as an essential market for Hong Kong's many small and medium size firms that are too small to export and “whose future is tied to the development of nearby provinces.” This is the main reason why Hong Kong, whose skills and capital are so essential to the development of the zone, is also keen to see the concept become a reality.

This should be possible, given China's record of building road and rail links quickly and the complementary strengths of the 9+2. While Guangdong's factories are thought to be as much as 2m workers short, the inland provinces have cheap labour in abundance. They are also rich in natural resources: Guangxi has alumina, tin and manganese, Guizhou has coal and both produce surplus electricity, while Yunnan has tea, tin and tobacco. Macau provides good trading links and Hong Kong the capital, management skills and professional services essential to finance and build the necessary infrastructure.

So far, however, the 9+2 concept exists only on paper. The economic development of the south two decades ago was successful in part because dictates from Beijing, such as the creation of the Shenzhen Special Economic Zone, were slavishly adhered to by local officials. Today, there is huge rivalry between provinces, towns and local districts, which explains, for example, the duplicate investment in ports and

airports in Guangdong. It has also led to unnecessary red tape and a host of trade barriers. Goods travelling across the region are routinely loaded onto different trucks at each provincial border, while tourists have to switch travel agents and guides from municipality to municipality.

Granted, state involvement is still necessary in a transition economy such as China's—to marshal resources and gain regulatory approvals. And it is quite right for the public purse to direct and finance major infrastructure investments. As Mr Enright notes, “development in the PRD followed the infrastructure. Whoever builds the first rail link or road determines long-term economic flows. It is not something the market does by itself.”

Already Mr Enright sees signs of a developing “enlightened self-interest” among provincial officials who are starting to see the benefits of, if not co-operating exactly, at least not competing. Huang Weiguo, vice-mayor of Foshan, is delighted at the “privileges” that his city enjoys from being close to Guangzhou: “We don't need to build an airport because Guangzhou already has one.” If more people were to start thinking along these lines, then 9+2 could really start to add up.

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North Korea

Missing person

Nov 18th 2004 | TOKYO
From The Economist print edition

A fuss over portraits says much about Kim Jong Il's regime

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HIS personality cult has so fully saturated North Korean life, it seems, that Kim Jong Il can get noticed now only by making himself scarce. The Russian news agency Itar-Tass created a stir this week by reporting that portraits of Mr Kim have been removed from some buildings in Pyongyang. An unnamed foreign diplomat told the agency that, in places such as the People's Palace of Culture, only empty rectangular spaces can be seen next to the customary portraits of Mr Kim's dead father, Kim Il Sung—still the Stalinist state's president in perpetuity. The younger Kim's portraits remain in many other buildings. But the strange news has had North Korea-watchers in overdrive.

This reaction is a sign of how hard it is to deal with Mr Kim's regime. Outsiders know little about how it functions, and what might make it collapse or lash out recklessly. Yet much hangs on the answer. Any collapse could send millions of refugees flooding into China and South Korea, and some experts fear that the missile-equipped regime could now have as many as ten nuclear weapons. So spooks and diplomats must feed on the most meagre scraps. In 2002, they made a feast of a government telephone directory that fell into their laps.

Another juicy morsel arrived this summer, when North Korean agents in France were seen buying an extravagant coffin and sending it back to Pyongyang. This and a few other scraps fuelled rumours that Koh Young Hee, one of Mr Kim's wives and the mother of a potential heir, had died. Mr Kim has hardly been seen since.

Is he grieving, or is something else wrong? Are his portraits being refurbished? Is Mr Kim cutting back on his own propaganda? Or have the pictures been removed as some sort of protest, and if so, why? While the speculation continues, one fact to remember about Mr Kim is that his nemesis, George Bush, has just won re-election. Thus emboldened, and having replaced the more doveish Colin Powell this week as secretary of state, Mr Bush will want to keep pressing Mr Kim to give up his nuclear ambitions. Yet this will hinge on how much authority and leeway Mr Kim has at home, and whether he will react better to a hard or a soft line. The awkward truth is that nobody really knows. It is not a pretty picture.

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The Philippines

Catastrophe on hold?

Nov 18th 2004 | MANILA
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The president is being too optimistic

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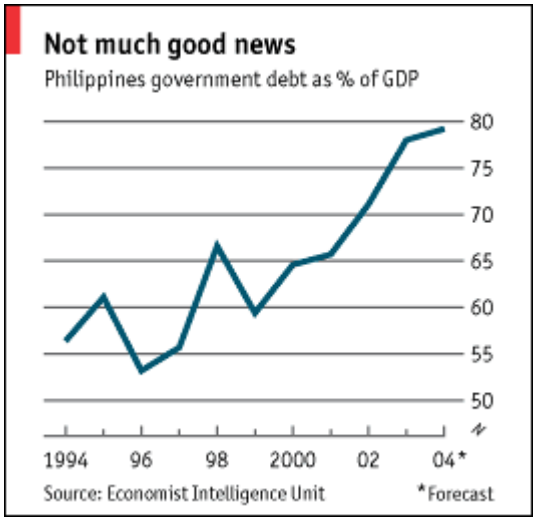

GOOD news: the Philippines, according to its president, Gloria Arroyo, has averted a fiscal crisis. Earlier this year, she herself had warned of impending catastrophe due to persistent budget deficits and ballooning public debt. She urged Congress to pass eight revenue-raising measures, and instructed the bureaucracy to tighten its belt. Now, she says, the country is out of the woods.

One reason for the president's optimism is the imminent passage of a law raising excise taxes on alcohol and cigarettes. In its current format, the increased tax should raise an extra 7.5 billion pesos ($135m) next year, although Congress might yet tinker with it. According to Joey Salceda, the chairman of the House of Representatives' economic affairs committee and an ally of the president, the government has a further 56 billion pesos' worth of tax rises and savings lined up for 2005, and is looking for another 13 billion pesos' worth. Further “pain packages” are planned for 2006 and 2007, of 58 billion and 33 billion pesos respectively. That should be enough, he says, to balance the budget by 2008.

But not everyone is cheering. Moody's, a ratings agency, has given warning of a downgrade. A series of grandees, from former finance ministers to professors at the University of the Philippines, argue that Congress is not doing enough. The problem is twofold: many of the government's proposed remedies are not yet in the bag, and even if enacted, they might not prove sufficient.

The Philippines' public debt amounts to about 80% of GDP, and adding in the debts of state-owned firms increases that to about 140%. The overall deficit this year will be about 7% of GDP. These figures do not take in various implicit debts, chiefly in the pension system. Signs of a debt spiral are obvious. Interest payments are already the biggest expense in the budget. Spreads on Philippine bonds are rising. The government's “primary surplus”, which ignores spending on interest, has fallen to just 0.6% of GDP; economists reckon it needs to rise to 4% to keep debt in check.

Mr Salceda's action plan assumes that the economy will continue to grow at its current healthy clip of about 5.5% next year, and even faster thereafter. Tax revenues are supposed to increase more rapidly still. But interest rates and inflation are likely to rise next year, while export growth will probably slow.

The rosiest assumption of all is that the plan will actually be implemented. The increase in excise taxes, if passed as expected some time next month, will mark the first time Congress has acted to boost government revenue in seven years. What is more, the tax increase is much less than the government had hoped for, and is not indexed to inflation. More aggressive measures that the president is counting on, like a 2% increase in the rate of value-added tax, will face a tougher fight in Congress.

This year, Congress did not even bother to enact a budget, leaving the 2003 one in place instead. If it repeats the same trick this year, several of the government's planned spending cuts will presumably fall by the wayside.

The president does have the power to raise import tariffs when Congress is not in session. She can also

reduce transfers to local governments in the event of an “unmanageable fiscal deficit”—but then again, according to her, the Philippines does not have one of those.

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Kashmir

Sticky wicket

Nov 18th 2004 | SRINAGAR
From The Economist print edition

India should know better than to expect Kashmiri gratitude

LIKE his predecessor, Atal Behari Vajpayee, India's prime minister, Manmohan Singh, came to Kashmir bearing gifts and a message of peace. He spoke on November 17th to a bused-in crowd behind the same bullet-proof glass in the same cricket stadium in the capital, Srinagar, where 19 months earlier Mr Vajpayee had extended "the hand of friendship" to Pakistan. Mr Singh tried something no less ambitious: to make friends with the Kashmiris themselves. Their reaction was churlish. But in the chilly autumn sun, prospects for peace seemed brighter than they dreamed possible when Mr Vajpayee spoke through April drizzle.

War was not far away, however. Before Mr Singh's speech Indian soldiers had had a three-hour shoot-out with two militants. They had somehow managed to hide themselves in a derelict building overlooking the stadium. Tens of thousands of Indian soldiers, Kashmiri and foreign militants and civilians have died in 15 years of insurgency against Indian rule.

Mr Singh had delivered his most important gifts in advance. A few days earlier, he had announced that India would withdraw some of its troops from Kashmir. This was the first such public promise from India since the uprising began. There are an estimated 500,000 soldiers, paramilitary forces and police in Kashmir, and the withdrawal may yet turn out to be small and symbolic. But even some separatists admitted it was an important symbol.

Also sparking some Kashmiri hopes, Mr Singh's government had said it would be prepared to consider new proposals for resolving the 57-year dispute with Pakistan over Kashmir if they were formally tabled. This may happen on November 23rd, when Pakistan's prime minister, Shaukat Aziz, will be in Delhi. His boss, General Pervez Musharraf, last month floated some vague but radical-sounding ideas, perhaps heralding big concessions.

The government probably hoped these positive signals would distract Kashmiris from protests over the latest alleged atrocity by Indian forces: the rape of a woman and her ten-year old daughter. It may also have hoped to persuade moderate separatist leaders to meet Mr Singh during his visit. The separatists, however, refused, demanding that the government first allow them to visit Pakistan to talk to militant leaders there. In his speech, Mr Singh made a moving appeal for unconditional dialogue, but did not yield to this demand.

For some Kashmiris, that was one of several disappointments. They had hoped for other political concessions, such as the release of detainees, or even a unilateral ceasefire from Indian forces. Instead, they heard a promise of massive central-government economic aid and a "new beginning" for the territory. Mr Singh ruled out any redrawing of international borders, or anything which smacks of a further division of India along religious lines.

Yet even separatists such as Umar Farooq, spiritual leader of the Kashmir valley's Sunni Muslims, accept that Mr Singh is a "decent fellow", and that there are some grounds for optimism. It was always unrealistic for Kashmiris to expect Mr Singh to come with dramatic political concessions. But the prime minister's advisers were equally over-optimistic if they expected Kashmiris to think much of Mr Singh's undoubtedly sincere pledge of "peace with dignity".

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Afghanistan

After the Taliban

Nov 18th 2004 | KABUL AND LASHKAR GAH
From The Economist print edition

New figures show Afghanistan's opium output is rising fast

Get article background

A DELUGE of sticky brown resin threatens to submerge the new Afghan state. According to figures released on November 18th by the UN's counter-narcotics agency (UNODC), Afghanistan has seen a huge rise in opium production for the third year running. UNODC puts the export value of this year's crop at $2.8 billion—equal to 60% of last year's GDP.

It could be worse. This year, 131,000 hectares of Afghanistan was sown with opium seed, a 64% increase on last year's figure. Yet the harvest, 4,200 tonnes of opium resin, was up only 17%. Western donors might like to put this down to their efforts to destroy the crop; they would be wrong. UNODC says eradication had little effect on yield. Only bad weather and crop disease prevented Afghanistan smashing its record of 4,600 tonnes of opium, produced under the Taliban in 1999. Nonetheless, over 95% of the heroin reaching Europe derives from Afghanistan.

What can be done? First, study the failure of existing efforts. In 2000, the Taliban banned opium production, thereby triggering a rise in the market price of the drug, and increasing the value of their copious stockpiles. The ban was rigorously enforced by savage beatings. The Taliban were then bombed from power, and Britain took charge of counter-narcotics in the new Afghanistan. Its policies have been more palatable, but less successful. To encourage opium farmers to remain abstinent, a British diplomat designed a poster featuring a red opium poppy. Alas, when the poster returned from the printers, the red poppy had become a pink tulip. The posters went out anyway.

Spending around $150m a year, Britain has formed an array of counter-narcotics departments and law enforcement agencies, which began functioning only this year. Money has also been spent on persuading poppy farmers to grow alternative crops, like fruit trees or saffron. The UN development agency meanwhile advocated floriculture—hoping to turn Afghanistan into a bed of roses. But, in the absence of almost any law enforcement, such schemes were hopeless. Even if Afghans could be persuaded to grow saffron, the country has few roads to give them access to markets. In fact, opium cultivation has no financial equivalent. Last year, each hectare under cultivation yielded 45 kilos of opium, which earned farmers $283 a kilo. This year, the price was $92—still not bad, when GDP per head is around $200.

Neither Britain nor the UN can curb the opium explosion. There is only one power in Afghanistan able to enforce the law: America, which has around 18,000 troops in the country, hunting the Taliban. This year, having been persuaded that the Taliban were using opium cash to buy arms, America waded in. At its behest, the government ordered provincial governors to destroy 25% of the poppy crop in their areas. A few did so, including the governor of southern Helmand. Yet his province still grew more opium than any other. In Lashkar Gah, the provincial capital, shiny tractors and SUVs mingle with camels and donkey-carts. The marble mansions of drug-dealers have mushroomed among the mud-brick houses. Helmand is ideal drug country: poor, lawless and close to the borders with Pakistan and Iran.

America also issued an American security company, DynCorp, with a $50m contract to train an Afghan eradication team. The team's 400 members got two weeks' training—long enough, says one diplomat, “to learn how to drive a tractor and point a gun.” Operating in central Wardak province, it caused chaos. Farmers fired rockets at the team's camp, and sowed their poppy fields with land mines. Yet it destroyed

1,000 hectares of poppy in six weeks, and should be expanded next year. This week, America announced an additional $780m for drug-control efforts.

Britain meanwhile pinned great hope on a top-level interdiction force, trained by its elite Special Air Service. Operating since January, the Afghan Special Narcotics Force has destroyed over 51 tonnes of opium and 32 heroin-producing labs. It has also arrested 20 mid-level drug traffickers, but, in the absence of a functioning justice system, none has been convicted. A drugs squad within the Afghan police force faces greater obstacles. When its commander tried to arrest a drug trafficker outside the gates of Kabul, the suspect summoned militiamen loyal to a senior minister. The police chief received a bloody nose.

Failing the return of the Taliban, Afghan drug traders will surely thrive if no-one is ever punished. To accelerate the creation of a new justice system—currently being designed by Italy—the UN plans to train judges and advocates specially to try opium traffickers, and to renovate a wing of Kabul's main prison to house them. In such an approach, alongside concerted crop eradication, and a continuing development of Afghanistan's economy, lies a distant glimmer of hope. Such was the formula next-door Pakistan used to eradicate opium from its northern provinces during a twenty-year campaign. Although, according to UNODC, opium is making a return there too.

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Iraq

Who's winning, really?

Nov 18th 2004 | BAGHDAD
From The Economist print edition

AFP

As the election looms closer, the country is still in a state of bloody flux—and it is not even certain that the election will be held on time

Get article background

MILITARILY, the United States and Iraq's interim government seem to have won a clear victory in Fallujah. Their forces, including token Iraqi units, claim to control the entire town, though they are still going door-to-door looking for diehard fighters in houses, mosques and even tunnels. They say they have killed 1,600-plus insurgents out of 3,000-odd thought to have been holed up in the town, at a cost, so far, of around 40 American and six pro-government Iraqi troops dead and several hundred wounded. No humanitarian teams were allowed to operate in Fallujah during the siege, nor is it clear how many of the town's 300,000 or so civilians were left (some say all but 50,000 fled), so the number of civilian casualties is unknown.

In any event, it was the battle's political aftermath that was bound to affect Iraq's future most. The marines' attack on the town in April prompted the insurgency to spread across many parts of Iraq. It briefly saw the Shias, who comprise about 60% of Iraq's population compared with the Sunni Arabs' 20%, seeming to endorse a simultaneous uprising by their more militant co-religionists that threatened to end the Shia establishment's policy of edgy co-operation with the Americans.

This time, many Iraqis fear that the assault on Fallujah will simply drive the insurgency elsewhere and make the general election set for the end of January even harder to hold. But the Shias do not seem minded to revolt again in sympathy, and the Kurds, who make up the remaining fifth of Iraqis, have remained the Americans' most steadfast friends.

In the short run, some of those fears that the insurgency might spread have been realised. As Fallujah burned, Sunni rebels elsewhere launched a wave of attacks across central Iraq, especially against police stations. Mosul, Iraq's largest northern city and the biggest in the country after Baghdad and Basra, was hit hardest. With its mixed population, 1m-strong, mainly of Sunni Arabs and Kurds, it hosts a large slice of Saddam Hussein's officer class and has, besides, a network of ultra-puritan Salafi mosques. Rebels stormed at least ten police stations there, plunging much of the city's western, Arab-dominated, half into anarchy. Some police shed their uniforms and joined the rebels. Others put themselves under the

protection of pro-rebel clergy.

After a few days the Americans took back most of the police stations but the rebels had won a moral victory by showing how weak the pro-government Iraqi forces still are, when left on their own. If the rebels can continue to make Mosul ungovernable, it will be a big blow to the Americans' hopes of holding a more-or-less fair election outside the Sunni triangle mostly to the west of Baghdad.

Still, the rebels do not seem to be gaining ground militarily. Their losses have been heavy and recruits may not be in endless supply, though it is feared that many of those who escaped from Fallujah may now throw in their lot with the most extreme groups, such as the one led by a Jordanian, Abu Musab al-Zarqawi, who seems to have slipped through the net—if he was in Fallujah in the first place.

More hopefully for the Americans and their Iraqi allies, the political process has not, so far, been derailed by the assault on Fallujah. The Muslim Scholars' Board, an influential generally pro-insurgent group of Sunni clergy, has told Iraqis to boycott the election—but would probably have done so anyway. Most of those Sunni groups who argued against the attack on Fallujah, but had previously said they would urge their adherents to vote, are still telling them to do so.

An unSunni outlook

The Iraqi Islamic Party, the main Sunni Arab group represented in the interim coalition government, has withdrawn its support but still wants to take part in the election. Its minister has changed allegiance to stay in the government, which is sounding out various Sunnis who have broadly endorsed the insurgents, with a view to bringing at least some groups and tribes into the fold.

So far some 70 small parties have registered for the election in January, and about a dozen big combinations of parties and groups, almost all of them with Sunni representation, are expected to do so soon. Because voters will be plumping for national lists, many of which will contain a cross-section of Iraqis, plenty of Sunnis will be elected to the national assembly, though they may not have the clout to bring the insurgents on board.

Compared with reactions across Iraq to the Fallujah battle in April, Iraqis this time seemed relatively sanguine. The two main pan-Arab television channels, al-Jazeera and al-Arabiya, were unable to broadcast as much as before from inside the city, though film of a marine apparently shooting a wounded insurgent was broadcast repeatedly. The flight of most civilians before the battle began, and the Americans' more thorough preparation for it, seem to have prevented greater civilian carnage. Most of Iraq's Sunni Arabs remain disaffected, but perhaps not more so than before. And many would probably welcome the removal of extreme groups, such as Mr Zarqawi's, from their midst—if it happens.

Meanwhile, voter registration among the Shia majority and among Kurds has gone ahead. Grand Ayatollah Ali al-Sistani, the Shias' most influential cleric, who has been sponsoring a pan-Shia electoral alliance, has been conspicuously silent about the attack. Followers of the firebrand Shia cleric, Muqtada al-Sadr, who rose up in April, have condemned the assault but had quietly signed themselves on to Mr Sistani's list before it began; with some notable exceptions, who are said to be urging a boycott, they appear to be sticking to that decision to participate.

The prospect, then, is of an election that may be fraught but more or less fair in, say, three-quarters of the country but impossibly dangerous for would-be voters in much of the Sunni triangle. Some members of the Iraqi government have quietly aired a suggestion that there should be a delay, to let the dust settle in places such as Fallujah and to give more Sunni parties a chance to register themselves and encourage their would-be supporters to vote. The interim president, Ghazi al-Yawar, a Sunni, may share that view.

It will be discussed next week at a conference hosted by the Egyptian government at the Red Sea resort of Sharm el-Sheikh. So far Iraq's American-backed government says it will stick to the January deadline. But if there were a real chance of a lot more Sunnis voting after a delay, it might be tempted to think again.

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Iran

Nuclear ambitions delayed

Nov 18th 2004
From The Economist print edition

But for how long?

Get article background

IT IS better that Iran's public efforts towards enriching uranium and producing plutonium are suspended, rather than not. That was the lukewarm reaction of the Bush administration to news that, after much dithering, and with behind-the-scenes technicalities still being worked on, Iran and the European trio of Britain, France and Germany appeared to reach a deal that had eluded them for more than a year.

Iran is happy that its breaches of safeguards will not be reported to the UN Security Council next week by a meeting of the International Atomic Energy Agency (IAEA), the UN's nuclear guardian. It also says it is confident that, in a few months, it will be back in the enriching business. It insists that suspension of such work will only be temporary.

The Europeans, however, hope to negotiate a permanent end to Iran's dabbling in nuclear-fuel technologies that could also help it build nuclear weapons. Too late? This week an Iranian exiled opposition group, the National Council of Resistance of Iran, accused Iran of buying some weapons-grade uranium and designs for a bomb from the same underground network, run by Pakistan's former nuclear chief, Abdul Qadeer Khan, that sold weapons blueprints and enrichment technology to Libya. Iran admits to buying civilian enrichment stuff but nothing else. America meanwhile said Iran was working to match nuclear warheads to its missiles.

Some of the exiled group's claims two years ago helped to unravel a web of nuclear experiments, many of them potentially useful to a military programme, that Iran had hidden from inspectors for 18 years. These were listed again this week in a new report to the IAEA's board. While confident that none of the nuclear material Iran has belatedly declared is being diverted to dodgy activities, the inspectors say they cannot yet be sure that nothing else is afoot in the country that shouldn't be.

The opposition group, meanwhile, claims that Iran is secretly continuing uranium enrichment and other activities at several previously unknown sites, including one near to a site at Lavizan, investigated by inspectors earlier this year. When the IAEA team got there, they found nothing untoward, except that all the topsoil and buildings had been removed.

Iran denies it was trying to hoodwink the IAEA, but as this week's report reminds the agency's board, Iran has tried to do so before. Now it insists it has come clean and should have its case dropped. Iran's president declared this week's deal with the Europeans to be a great victory. The Europeans, disappointed by previous dealings with Iran, are less sure.

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Aid agencies

More dangerous work than ever

Nov 18th 2004
From The Economist print edition

Why so many aid agencies have been forced out of hot spots

Reuters

Margaret Hassan, killed for helping

THE apparent murder in Iraq of Margaret Hassan, head of CARE International in Baghdad, who was British and Irish and married to an Iraqi, underlines the fact that aid work is one of the most dangerous professions in the world. Mrs Hassan, who had lived in Iraq for 30 years and had run CARE's life-saving activities there for 13, was kidnapped in Baghdad a month ago. She was being held by an unnamed but presumably fundamentalist Islamist group that was evidently indifferent to her reputation for helping ordinary Iraqis and to her opposition to America's invasion.

In the past decade, more than 200 of the United Nations' civilian staff have been killed by “malicious acts” in 45 countries. Nearly 300 more, civilians and peacekeepers, have been taken hostage. The International Committee of the Red Cross (ICRC) has lost 40 of its staff on mission over the same period. Hundreds of other unarmed aid workers have been killed, maimed, abducted and assaulted as they have tried to help people in some of the world's most benighted places.

Humanitarian outfits have long been used to being caught in the crossfire. What is new is the deliberate way they are now being targeted, particularly in Iraq and Afghanistan. Three UN aid workers in Afghanistan are still under threat of decapitation. A suicide attack in October last year on the ICRC's headquarters in Baghdad killed ten people. Another suicide bomb two months earlier in the UN's Baghdad headquarters killed 22, including Sergio de Mello, the UN's special envoy. This summer five members of Médecins Sans Frontières were murdered in cold blood in Afghanistan. And so it goes on.

Most of the big relief agencies, such as Oxfam, CARE and Médecins Sans Frontières, have now left Iraq. The ICRC remains, largely incognito and for the first time in its history without the cover of its red cross. The UN, which is supposed to be overseeing Iraq's election in January, is still operating in Baghdad, but with an expatriate staff of just 35, down from more than 300 before last year's attack.

Until the early 1990s, the UN's blue flag and the ICRC's red cross almost guaranteed protection against attack. No longer. Instead of being accidentally killed because they happened to be in the wrong place at the wrong time, clearly identified aid workers began to be murdered—in the Balkans, Sierra Leone, Africa's Great Lakes region, Chechnya, Colombia. But their deaths usually had more to do with local factors than their professional affiliation.

It was not until the American-led wars in Afghanistan and Iraq that the UN and other aid agencies began to be deliberately hunted down. Mostly based in rich countries and funded by a mixture of independent charities sometimes with government help, they have come to be regarded by many of those who once relied on them as part of a western plot to subjugate the Muslim world—though more than half the beneficiaries of the UN and the ICRC are Muslims. The blurring of lines between humanitarian and military roles, with coalition forces in Afghanistan and Iraq perceived to be handing out baby food one day and dropping bombs the next, has not helped. Nor has President Bush's “you are either with us or against us” approach.

As a result, say the aid people, the neutral “humanitarian space” in which they seek to operate has drastically shrunk. They are now regarded as semi-official distributors of western government relief rather than independent impartial agencies whose sole aim is to help those in need, regardless of politics,

religion or ideology. So they are all now urgently reviewing their security.

The UN “cannot succumb to a bunker mentality”, says Kofi Annan, its secretary-general. A degree of risk is unavoidable; the challenge is to lessen it. He describes a new package of security measures costing $97m as “one of the most important proposals, if not the most important” he had put to the General Assembly during his eight years in office. The safety of the UN's 100,000 officials and their 300,000 dependants around the world had become his “first priority”, he said.

Brave words. But will they prove any more effective against targeted terrorist attacks than the blue flag?

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Palestine

Looking for a leader

Nov 18th 2004 | RAMALLAH
From The Economist print edition

The interim one, Mahmoud Abbas, is being told what to do

EPA

Abbas out of the shadow?

ON THE surface, the transition went smoothly. Within hours of Yasser Arafat's death, Mahmoud Abbas (Abu Mazen) became chairman of the Palestine Liberation Organisation (PLO), its first new leader in 35 years. Ahmed Qurei (Abu Alaa), the Palestinian Authority's prime minister, became head of the National Security Council, with a brief to drum order into the fractious police forces. And Rauhi Fattouh, the legislature's speaker, became the PA's interim president, with the sole remit to organise a presidential election, which has been set for January 9th.

But beneath the surface, turbulence bubbled. On November 14th, masked gunmen broke into the mourning tent in Gaza where Mr Abbas and Mohammad Dahlan, a former PA security minister, were receiving condolences. A gunfight erupted, leaving two police officers dead. Though Messrs Abbas and Dahlan insisted this was not an assassination attempt (probably true, since the gunmen could have easily killed them if they had wanted to), it was unmistakably a warning.

The gunmen have links with top men in Arafat's Fatah movement, the biggest in the PLO, and they carried two messages for Mr Abbas: do not leave us out of the loop in the post-Arafat era, and do not depart from Arafat's legacy. That legacy is uncompromising: Palestinian sovereignty in Jerusalem, the right of return for Palestinian refugees and a commitment to continue the *intifada*, the Palestinians' armed revolt against Israeli occupation.

There have been lesser warnings. In a rush after Arafat's death, Fatah's “old-guard” leaders nominated Mr Abbas as their candidate for PA president. No, said the young guard, activists born and bred in the occupied territories who have emerged as leaders-in-waiting during the *intifada*. They wanted the Fatah candidate to be chosen by primaries throughout the movement. They also wanted Marwan Barghouti, the general secretary of Fatah in the West Bank, to be their man.

Mr Barghouti is serving five life sentences in an Israeli jail for his part in deadly attacks on civilians. Were he to run, he would almost certainly defeat Mr Abbas (see our chart). He has the support of crucial parts of Fatah, including many of the fighters who have long viewed him as the only real heir to Arafat's throne. He would also get the vote of large numbers of other Palestinians. Opinion polls have routinely shown him to be the most popular politician in the occupied territories after Arafat.

So could there now be a changing of the guard? Probably not, say Fatah sources, though there are many in the movement who would wish so. This is not just because it is extremely unlikely that Ariel Sharon, Israel's prime minister, will free Mr Barghouti (except, perhaps, as part of a prisoner exchange with Hizbullah, the Lebanese guerrilla movement). It is also because Mr Barghouti, at least for now, apparently wants to resurrect the tactical pact he forged with Mr Abbas's brief government last year.

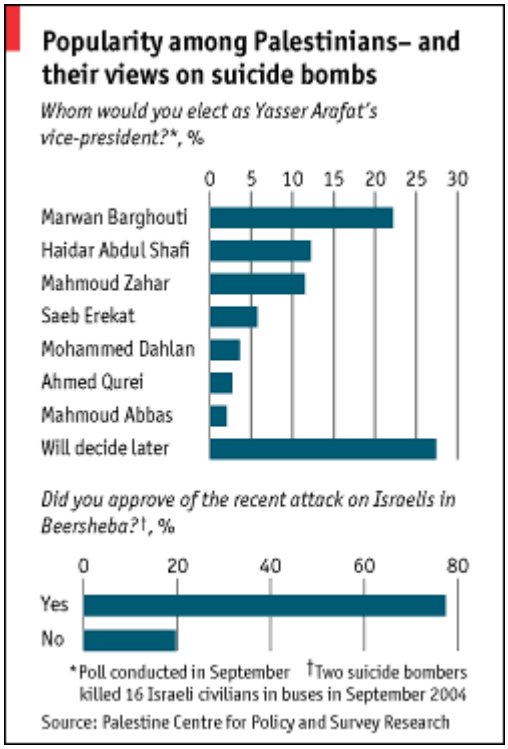
That pact boils down to a trade. Mr Barghouti will support Mr Abbas's presidency and policies if, in return, Mr Abbas prepares for a new general election, and gives absolute priority to attempts to

free the 7,000 or so Palestinian prisoners in Israeli jails.

Others are making similar demands of Mr Abbas. This week he met all the Palestinian factions, including the Islamists of Hamas and Islamic Jihad, the most powerful force in Palestinian politics after Fatah. The Islamists want parliamentary as well as presidential elections on January 9th, though they say they will not put up a candidate for president, and they too are calling for prisoners to be released.

But Mahmoud Zahar, Hamas's leader in Gaza, is making further conditions. The Islamist groups, he says, will not accept Mr Abbas's proposal for a new Palestinian ceasefire unless it is accompanied by guarantees from Israel that it will stop its military incursions into Palestinian areas and that it will end its policy of assassinating Palestinian leaders.

Mr Sharon is not prepared to do any of this. The most he has offered are gestures to facilitate the presidential election, including arrangements to let 220,000 Palestinians in East Jerusalem vote. Any political negotiations, he insists, remain predicated on the new Palestinian leaders acting against the militias, both in Fatah and in Hamas. Dream on, answers Mr Dahlan.



"Whoever thinks that in a month or two we'll be able operate [police] forces [against the militias] is deluded," he told Israel's *Yediot Aharonot* newspaper. Since the PA is devastated, he said, the new leadership has first to put its house in order. That will plainly take time. But whether time is on Mr Abbas's side is still open to question.

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Arafat and the cash

Mess of fact and fiction

Nov 18th 2004 | JERUSALEM
From The Economist print edition

One of the many mysteries he left behind

SO WHAT about Yasser Arafat's financial empire? Speculation is buzzing about the investments, businesses and bank accounts spread across the globe to which only that late Palestinian leader had the codes. “This money belongs to the Palestinian people,” says Hassan Khreishe, Palestine's new parliamentary speaker. He wants a probe into all of Arafat's accounts, including those of his Fatah movement and the Palestine Liberation Organisation (PLO).

Like so much of Arafat's legacy, the “missing millions” are a mess of fact and fiction. The PLO was one of the richest liberation movements ever. In the mid-1980s its holdings were estimated at $5 billion, fuelled by Arab donations of around $200m a year, mostly from the Gulf states. But after its dalliance with Saddam Hussein in the 1991 Gulf war, the cash pipelines were cut, and the PLO was pitched into crisis. Thousands of functionaries were laid off, and services to refugees were reduced.

Arafat's fortunes revived with the signing of the 1993 Oslo accords, and the cash they brought to his fledgling Palestinian Authority (PA). But the finances were as murky as ever. Between 1994 and 2000, some $900m of PA revenue never got to the treasury. It was siphoned off into holdings abroad or held in a Tel Aviv bank account under Arafat's name. The world, and Israel, closed an eye, preferring in those days to let Arafat rule by his own methods.

Eyes were opened again after the eruption of the *intifada* in 2000, and Israel's charge that aid money was being used to finance suicide bombers. The European Union, the PA's largest donor, launched a probe, but found no evidence to substantiate Israel's claims.

In 2002, the IMF forced Arafat to sign over his investments to a single PA fund. According to the IMF's representative, some of the missing $900m has been restored to the PA, and is now under the control of Salim Fayyad, the finance minister, whose reforms have won praise from donors.

Mr Fayyad has no watch over PLO and Fatah investments. Their worth is unknown, with guesses ranging from billions to a few million. But most Palestinians agree that, in the last months of his life, Arafat was no longer the font of patronage that he had been.

One of the causes of recent protests by PA police officers was that their salaries were no longer being paid in cash. This had been one of Arafat's ruses to employ more people than Israel allowed him to. When a police delegation went to him to complain, he replied: “I no longer have the money. Go talk to Salim.”

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Namibia

A new old man

Nov 18th 2004 | JOHANNESBURG
From The Economist print edition

A new president may, at least to begin with, be just a cover for the old one

Reuters

HE LEAVES office in March, but when does he give up power? Namibia's 75-year-old Sam Nujoma, who has been president since independence in 1990, is reluctant to go. This week voters chose a successor, handpicked for them by the “old man”. The new man, Hifikepunye Pohamba (right), is a grey-bearded lookalike, aged 69, who co-founded the ruling South West Africa People's Organisation (SWAPO) with Mr Nujoma 45 years ago.

Mr Pohamba, until now the minister for land, vows only to “uphold the legacy” of his predecessor, who will move into a palace just built by North Korean contractors for an estimated $60m, making State House look pretty humble by comparison. Mr Nujoma will remain SWAPO's boss, at least until 2007, and will retain generous powers of patronage, choosing heads of key state-run bits of the economy.

Namibia's 1.8m people won't grumble if Mr Nujoma calls the shots for a bit longer. Their country is stable, relatively uncorrupt, and quite high in Africa's prosperity league. The economy is expected to grow by 5% next year, mostly thanks to tourism and mining. There are fears of a Zimbabwe-style grab of white-owned farms. Both Messrs Nujoma and Pohamba have promised a drastic land redistribution, and the government has served expropriation orders on a few such farms.

Mr Pohamba's priority should be the populous north, which suffers from AIDS, poverty and joblessness. SWAPO fought a long guerrilla war for independence near the border with Angola; the locals seem sure to vote for him. As with other political parties in southern Africa that came to power as liberation movements, SWAPO plainly presumes a right to govern for many years to come—whoever runs it.

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Euro economies

Virtue unrewarded

Nov 18th 2004
From The Economist print edition

Europeans might consider it unfair if America escapes the consequences of its past profligacy at their expense

HOPES that the euro-area's economies might be perking up have been dashed by the latest GDP figures. The area grew at an annual rate of only 1.2% in the third quarter, half as fast as in the first half of 2004. The two biggest economies, France and Germany, grew at annual rates of only 0.4%, compared with 3.7% in America. Not only is domestic spending still weak; exports, hitherto the main driver of growth, have slowed. Fears are mounting that another rise in the euro could tip Europe's economies back into recession.

Since the end of 2000, America's output has grown more than twice as fast as the euro area's (see chart). Euro-pessimists see this as further evidence that arthritic economies are being held back by lazy workers and by governments unwilling or unable to carry out reforms. In contrast, America's more robust recovery, it is often said, reflects its amazing flexibility.

America's productivity growth has indeed been faster than the euro area's. Yet most of its GDP growth since 2000 is down to big tax cuts and lower interest rates, which fuelled a consumer-spending binge. Such policies are not sustainable. America's structural budget deficit (after adjusting for the economic cycle) stands at 4.5% of GDP, almost three times as big as the average in the euro area; its household saving rate has fallen to 0.5%, compared with 12% in the euro area; and its current-account deficit is almost 6% of GDP, while the euro area runs a modest surplus. Such imbalances suggest that America's future may be a lot less rosy.

This is not to deny that the euro area's economic performance has been dismal. Germany's Council of Economic Advisers forecast this week that the economy would grow by only 1.4% in 2005, no better than in 2004. Some of the weakness in both Germany and its neighbours may reflect the short-term impact of government and corporate reforms, which may be boosting long-term competitiveness, but are also dampening wages and thus consumer spending. Worries about job and social-welfare cuts have also taken their toll on consumer confidence. Retail sales in the euro area have remained flat over the past year.

On the other hand, thanks to low wage increases and a pick-up in productivity growth this year, profits in

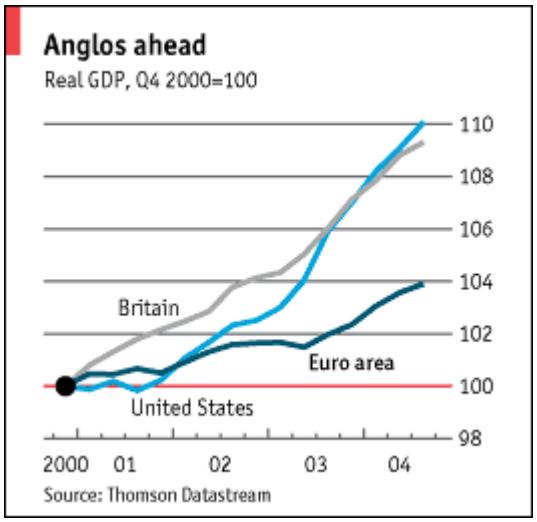
the euro area are now rising at their fastest pace for a decade. It is striking that, despite relatively slower GDP growth, share prices in the euro area have outperformed Wall Street in the past two years.

Awkwardly, the faster that governments and companies push ahead with reforms to make labour markets more flexible and so boost long-term growth, the weaker consumer spending is likely to be in the short run. But other reforms could boost demand. One possible reason why inflation has remained above the European Central Bank's ceiling of 2%, despite low growth, is a lack of price competition. Not only does this force the ECB to run a tighter policy than it otherwise would; high prices are also directly curbing consumer spending.

A study by Ben Broadbent, an economist at Goldman Sachs, finds that, although consumers in America and Britain have enjoyed a sharp fall in the prices of clothes in recent years, thanks to imports from low-cost countries, clothes prices have not fallen in the euro area. One explanation may be that retailers, insulated from fierce competition, have not passed on cost savings. Measures to boost retail competition could thus increase demand.

Over the past couple of years, Europe's economies have been supported by strong export growth. But that is now being threatened by the rise of the euro, which has already appreciated by more than 50% against the dollar in the past three years. The euro's trade-weighted value, however, has risen by much less, taking it back to its value at launch in January 1999. This is because only 16% of the area's exports go to America, compared with almost 50% to the rest of Europe.

In any case, a strong currency can have advantages. It helps to reduce inflation and hence interest rates, and by intensifying competition it should speed up structural reforms in Europe. Even so, if the euro rises towards $1.50, as some predict, many European businesses will be hard pressed.



So far the ECB has tried to talk down the euro, but it has not intervened in the currency markets. Such intervention is unlikely to succeed without the help of America. John Snow, America's treasury secretary, claimed during a visit to Europe this week that America still supported a “strong dollar”. But the markets now suspect that America is happy to let the dollar slide, as an easy way to reduce its vast current-account deficit without suffering a slump in demand and jobs. If that is right, America's gain may be Europe's loss.

Mr Snow also argued that the euro area's slow growth was partly to blame for America's growing current-account deficit; he urged Europe to boost demand. But this is easier said than done. With real interest rates in the euro area already negative, and average budget deficits around 3% of GDP, there is little room for stimulus. Structural reforms may boost growth in the long term, but not immediately.

If the dollar keeps falling, Europeans may feel that it is unfair that Europe should now suffer after years of profligacy by America's consumers and government. America is seen as a prodigal son who has squandered his wealth through wild living. His European brother, who has lived prudently, has no desire to bail him out now that his luck is running low.

Policymakers in Europe insist that, rather than rely on a fall in the dollar to correct its trade deficit, America should save more by cutting its budget deficit. Yet if that reduced American demand, European exporters would still suffer. Anyway, America is unlikely to heed Europe's advice. As Jean-Claude Juncker, Luxembourg's prime minister, put it this week, “I think there is an underdeveloped sense of hearing in the United States”.

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German workers' representation

Goodbye consensus?

Nov 18th 2004 | BERLIN
From The Economist print edition

An overdue debate about reforming German co-determination

Get article background

IMAGINE your company has a governance structure that works, but is a hard sell to investors. Should you change it, even if that causes trouble, and there are more pressing problems? Germany is pondering whether to weaken its *Mitbestimmung* (co-determination), which gives its workers' representatives more votes on boards than those anywhere else in the rich world. This week the Confederation of German Employers' Associations demanded change. And the government must decide if co-determination should apply to German firms that opt for the Societas Europea, the EU's new form of company.

Workers' representatives make up as much as half of a German supervisory board, depending on company size. This is largely thanks to the British, who, as post-war occupiers, allowed industry and unions in the Ruhr to adopt “equal representation”, partly in the hope of putting Germany's military-industrial complex in a straitjacket. Co-determination was then extended and, in 1976, became compulsory for all big companies.

No other country has gone as far as Germany, although most big EU members have some sort of co-determination. Employers usually dislike power-sharing, though it can bring some advantages. It is one reason why strikes cost Germany five working days per 1,000 workers a year in 1993-2002, against 25 days in Britain and 45 in America. Polls suggest that a majority of Germany's executives like it, and are not afraid to say so—as Jürgen Schrempp, boss of DaimlerChrysler, did recently.

Yet critics say this support is part of the problem. Bosses play nice because they need the votes of workers' representatives; without them, Mr Schrempp would long since have been fired. This, it is argued, aggravates Germany's corporate-governance ills, notably slow decision-taking. And some say that German co-determination is dying anyway. Foreign investors increasingly avoid it; German firms flee it by moving to other countries. Freed of co-determination, they may even sneak back as a French SA or British plc, now legal after recent European court decisions.

Regulatory arbitrage may thus force Germany to make adjustments. This week's reform proposals would be a starting-point. They respond to the main weaknesses of co-determination: supervisory boards are too large, foreign employees are not represented and equal representation may not be the optimal model. The employers want managers and unions to negotiate over which model they want, including one in which workers' representatives make up only one-third of the supervisory board, the standard set-up elsewhere in the EU.

Yet going for changes now may be a mistake, which is why Chancellor Gerhard Schröder has said no to them. Unions have been quite flexible recently, as cost-cutting deals at Siemens and Volkswagen show. And it is precisely in times of economic pain that co-determination may be most helpful: workers who have a say may accept change more readily.

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Italy's chaotic politics

Taxing times

Nov 18th 2004 | ROME
From The Economist print edition

After the calm, the storm

FOR some months, predictions earlier this year of a fracture within Silvio Berlusconi's coalition had seemed misplaced. But after a week of acrimonious confusion bordering on outright chaos, it now seems they were just premature.

At the root of the government's problems lie two things: Italy's glum economy and Mr Berlusconi's pledge before coming to power in 2001 to cut income tax. The prime minister's legal battles—his trial in a judge-bribing case may produce a verdict against him in December—also keep dogging his government.

At a coalition "summit" on November 9th, ministers accepted that, with Italy's economy sluggish and the budget deficit up against the euro area's agreed ceilings, the money was not there for a tax giveaway. Instead it was agreed that income-tax cuts should be put off for a year. But, to show willing, it was also decided that the budget should include some €3.5 billion ($4.5 billion) in corporate-tax cuts and tax breaks for poor families. The deal opened the way for the former neo-fascist, Gianfranco Fini, to become Italy's foreign minister in place of Franco Frattini, who is replacing Rocco Buttiglione as Italy's European commissioner. But Mr Berlusconi was reluctant to let Mr Fini have the foreign ministry without getting something in return. Mr Fini is sceptical about tax cuts, and the prime minister wanted him to accept at least some.

That Mr Fini agreed to so few before becoming foreign minister was embarrassing enough for Mr Berlusconi. But, as details emerged of the spending cuts needed to contain Italy's deficit and pay for these modest tax cuts, pent-up tensions in the government burst out. The deputy finance minister, Gianfranco Micciche, responsible for development funds for the south, threatened to resign if they were cut. The Northern League, a junior coalition partner, hinted it would bring down the government if they were not.

As accusations and denials flew, it became increasingly hard to grasp what was in the budget. On November 15th teachers protested in Rome amid reports that education cuts would cost 14,000 jobs. The education minister, Letizia Moratti, dismissed the reports—only to discover that they were true, and to join the teachers in damning them as unacceptable. Mr Berlusconi himself raised tensions by telling colleagues he had not given up the struggle for income-tax cuts at the start of 2005.

Called to parliament to clarify the situation, the finance minister, Domenico Siniscalco, conceded that the tax cuts had "still, in part, to be defined within the government". In the ensuing uproar, the opposition withdrew its amendments to the 2005 budget, saying it did not know what it was amending. The government followed suit. Bizarrely, the budget was then passed without further ado by the lower house. It now goes to the upper house.

The Northern League's leader, Umberto Bossi, still in hospital with heart problems, is now reportedly pessimistic about the government's chances of seeing out its term to 2006. He is not alone. The budget is exposing deep divisions in the coalition, between interventionists and neo-conservatives, and in the country, between a poor, dependent south and a rich, frustrated north. Above all, the frailty of the Italian economy—and how little was done in the early years of the Berlusconi government to reform it—is showing through ever more starkly.

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Spain and Basque terrorism

Ceasefire ahead?

Nov 18th 2004 | SAN SEBASTIáN
From The Economist print edition

A weakened ETA considers its future

Get article background

ARNALDO OTEGI, leader of Batasuna, the banned political wing of the Basque terrorist group ETA, pledged at a rally in San Sebastián last weekend that he would “take the conflict off the streets and bring it to the negotiating table”. Expectations had not been high, but his declaration was still greeted with derision in Madrid. The justice minister, Juan Fernando López Aguilar, said “we neither heard a clear and resolute condemnation of violence, nor the definitive renunciation of continuing to threaten individual freedoms.” The opposition People's Party asked why Batasuna had been allowed to hold a rally at all. Many observers saw a cynical bid by the party to regain legal status before the Basque regional elections next May.

Nobody in Madrid is ready to negotiate with a party whose ban in March 2003 is seen as a success, still less talk to ETA. Last month French police arrested the organisation's suspected top leader, Mikel “Antza” Albizu Iriarte, along with 20 others, prompting speculation that the group was close to extinction. The Spanish claim (as they have before) that ETA has been brought to its knees in the past two years, after police operations netted over 200 suspects in Spain and south-west France. Over a dozen were arrested in the run-up to the Batasuna rally, and this week the Spanish police arrested a further 17.

ETA's operational capability appears to be hamstrung. It has not carried out a fatal attack since a car bomb in May 2003 that killed two policemen in Navarre. On the eve of the Batasuna rally two bombs exploded at a remote army post in the Pyrenees, but caused no injuries. The al-Qaeda train bombings in Madrid in March have made it harder for ETA to resume its terror campaign—though this week it insisted it would not renounce violence.

Speculation over a ceasefire had risen after ETA issued a communiqué calling for negotiations. It also lent full support to the Batasuna leadership, normally seen as politically subservient to ETA. Then came a letter from six jailed senior Basque terrorists urging ETA to abandon its 36-year campaign of violence. The authors advised it to back “institutional and mass struggle” for an independent Basque homeland. “Our political-military strategy has been overcome by our enemy's repression against us,” wrote the jailed terrorists. One signatory was Francisco Múgica Garmendia, ETA's leader in the late 1980s and early 1990s. Mr Garmendia presided over one of ETA's most violent periods: between 1985 and 1990 it killed almost 200 people. He was arrested in 1992 and is now one of nearly 700 ETA members in jail.

Mr López Aguilar welcomed the news that some in ETA were rejecting violence, but added that he would not let his guard down. Spanish security sources suggest that Batasuna's peace plan could yet presage an ETA ceasefire, possibly before Christmas, which might give the party time to present itself for May's elections. Electioneering has already begun. The Basque premier, Juan José Ibarretxe, who still plans to hold a referendum on Basque independence, has said that his dream is for Batasuna to take part in the democratic process. Three Basque Socialists, including the mayor of San Sebastián, have said that Madrid should reconsider the ban if Batasuna “chooses the path of peace”.

In 1998 ETA called a ceasefire, which it used to rearm and which ended after 14 months. Spain is not in the mood to acclaim another ceasefire; it wants ETA to give up the armed struggle. Josu Jon Imaz, president of the Basque Nationalist Party, says anyway that, if ETA returns to killing, it could be the last straw for its support base, leading to its definitive extinction.

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Azerbaijan

Long live the king

Nov 18th 2004 | BAKU
From The Economist print edition

Aliev junior turns out to be much like Aliev senior

Get article background

A YEAR after Ilham Aliev became president, you might be forgiven for thinking his father, Heidar, still ruled Azerbaijan. The Soviet veteran, who dominated the country for over 30 years before his death at 80 last December, is omnipresent. He gazes from billboards everywhere. In Baku, the airport, a main road and a concert hall have been renamed in his honour. Every government office displays his portrait. His face appears even on carpets.

Ilham Aliev has yet to escape the paternal shadow. Policy is unchanged, as is most of the presidential entourage. “People wanted to continue Heidar Aliev's ideology,” says Mubariz Gurbanly, of the ruling New Azerbaijan party. “That means Azerbaijan becoming the most powerful country in our region, uniting all Azerbaijanis around one idea and restoring our territorial integrity.” This refers to Nagorno-Karabakh (see article). On the entourage, he notes that people from the “school of Heidar Aliev” guide Ilham.

Those who had hoped that the younger Aliev might liberalise are disappointed. What remains of the opposition inspires little loyalty among voters. Isa Gambar, head of one opposition party, Musavat, claims that he was cheated in last year's presidential elections, and that his followers have been denied television coverage and permission to demonstrate ever since. “The authorities love power very much and are ready to do anything to keep it,” declares Ali Kerimli, leader of another opposition party, the Popular Front.

Although many political prisoners have been freed, seven Aliev opponents have just been jailed for their role in street protests after last year's election. Others have been tortured. The head of an interior ministry unit allegedly responsible has been promoted, says Arzu Abdullayeva, head of the local Helsinki Citizens' Assembly. Ms Abdullayeva thinks Ilham may be a softer version of his father, but that closed-minded advisers call the shots. “He's not really in power at all. De facto, it's Heidar Aliev's team ruling.”

With billions of dollars pouring into Caspian oilfields, Azerbaijan ought to be quite rich. In the past two years, buoyant oil prices have pushed annual GDP growth into double figures. Yet outside Baku, there is little sign of prosperity. Almost half the population lives in poverty. The minimum wage is $20 a month. As many as a quarter of the country's 8.3m people have emigrated. The latest corruption assessment by Transparency International ranks Azerbaijan 140th out of 146 countries.

The government insists that things are improving. Ilham Aliev is promising 600,000 new jobs and has set up an anti-corruption commission. Yet life remains tough for most. Next year petrol and gas prices will rise sharply as part of economic reforms. “Heidar or Ilham? I don't see much use in either,” concludes Elshen, a carpet-seller in Baku's walled old town. “Politicians play their games, and the people are the victims.”

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Nagorno-Karabakh

Small war, big mess

Nov 18th 2004 | STEPANAKERT
From The Economist print edition

A deep-frozen conflict continues to infect the region

ARRIVE in Stepanakert, capital of Nagorno-Karabakh, and nothing suggests it is a war zone. The streets are clean, public buildings refurbished, there is a good hospital, a television studio, casinos, hotels and even a fitness club. The road that links Karabakh to Armenia may be the best maintained in the Caucasus.

In the mind of Karabakh's Armenians, their bitter war to break free of Azerbaijan in the early 1990s, in which some 25,000 people were killed, is won. They have a president, a flag and a small army. “The issue is resolved,” says Gegham Baghdasarian, editor of *Demo*, a local newspaper. “The people made their statement, then defended it.” But for Azerbaijan, the war is not over. A ten-year ceasefire is holding, just, but thousands of Azerbaijani and Armenian troops face off across minefields. Not only Karabakh, but seven other Azerbaijani regions—14% of Azerbaijan's area all told—are occupied by the Armenians.

Border blockades imposed by Azerbaijan and its ally Turkey have turned Armenia into a backwater dependent on Iran and Georgia for access to the outside world. Between the two former Soviet neighbours there are no air, road or rail links. Azerbaijan has made sure that a new oil pipeline from the Caspian to the Mediterranean bypasses Armenia. About a million people on both sides were ethnically cleansed from Armenia and Azerbaijan during the conflict. None has returned.

Nor, despite the prosperity in Stepanakert, is life easy for the Armenians running Karabakh. Their “republic” remains unrecognised. It is less an independent entity than an extension of Armenia. The army is deeply integrated with Armenia's, the currency is the Armenian dram, cars have Armenian number plates. Armenian “credits” and gifts from the Armenian diaspora account for Nagorno-Karabakh's good infrastructure.

Shusha, near Stepanakert, illustrates the problem. Once one of the most charming places in the Caucasus, it is now a ghost town of gutted buildings and overgrown graveyards. Its Azeri population is gone. Many inhabitants are Armenian refugees from Azerbaijan, living wretchedly in what remains of ransacked apartments. Filip Noubel, an analyst at the International Crisis Group, says that renewed war is unlikely. But, he adds, the stand-off is being manipulated by both governments, undermining democracy in both countries.

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Charlemagne

Chirac-lite

Nov 18th 2004
From The Economist print edition

The competition for the right foreign-policy vision for the European Union

IS ATLANTICISM dying? This week Britain's Tony Blair, freshly returned from Washington, DC, made a passionate speech, pleading for the importance of greater co-operation between the United States and Europe. Even France's Jacques Chirac, the arch-exponent of the need for a European superpower and a multi-polar world, made soothing noises about the importance of transatlantic ties, telling British journalists ahead of a visit to London that “constructing Europe in opposition to the United States makes no sense”. Mr Chirac is careful with his words, because he knows there are few takers in Europe for a competitive, antagonistic relationship with America. What is emerging instead is a Chirac-lite approach.

Chirac-lite is based on the assumption that Europeans and Americans often see the world differently. While they may share the same broad goals—peace in the Middle East, stopping nuclear proliferation—they differ more and more frequently over the means. Chirac-lite has been quietly gaining converts, because the growing perception of an American failure in Iraq has bolstered the position of those in Europe who argue for keeping their distance from the Bush administration. The emergence of distinct European policies is now visible across a range of issues, from Iran to the Middle East peace process, and from global warming to the lifting of the western arms embargo on China. And, with the possible exception of the Chinese arms embargo, these are all matters where even Tony Blair is closer to the European than to the American position.

Iraq continues to overshadow all else. The Americans once hoped that success in Iraq might persuade more European countries to sign up to the mission. Now they are struggling to prevent the current members of the coalition from following the Spanish example and pulling out. The Dutch, the Hungarians and the Poles have all signalled that they hope to bring their troops home soon. And problems in Iraq act as a drain on the credibility of Atlanticism across the board. Those countries that sided with the Americans are often deemed to have participated in a failing venture, for which they have gained little in return, a point that Mr Chirac was careful to rub home to the British this week.

The failure of the Americans to launch a bold new peace initiative in the Middle East is exhibit one for Europeans who argue that Mr Blair's Atlanticism has paid no dividends. Formally, the Europeans and the Americans are signed up to the same “road map” for Middle Eastern peace. In practice, there are crucial differences that go well beyond America's supposed bias towards Israel and Europe's alleged fondness for the Palestinians. The argument is also about the feasibility of launching a big peace push under current circumstances. The Americans, with bitter experience of how the Oslo peace process unravelled, are sceptical. They argue that, with Israel's Gaza pull-out in the offing, and the Palestinian leadership in flux, it makes more sense to go step-by-step. The Europeans, however, continue to press for a dramatic new initiative in the wake of Yasser Arafat's death, as a vital component of the “war on terror”.

The Europeans are mainly grumbling over Palestine. But they are actively trying to seize the initiative over Iran. The foreign ministers of Britain, France and Germany, together with Javier Solana, the EU's foreign-policy chief, are still working on a deal to persuade the Iranians voluntarily to abandon their ambitions to develop nuclear-fuel technologies that could also enable them to build nuclear weapons. This week they said that Iran would suspend its uranium enrichment and plutonium reprocessing activities, in return for European concessions over trade. But the Europeans say they are getting scant support from America. “The best we hear from Washington”, says one EU diplomat, “is that they hope we succeed, but that they think we will fail. But there is another school that thinks our initiative is actually harmful because it allows the Iranians to stall.”

The stakes are high. America is pressing for sanctions if Iran continues to pursue its nuclear programme, and some senior American officials believe that the quarrel will ultimately end in armed conflict—maybe

with a raid on Iran's nuclear facilities. Such a prospect is greeted with horror in Europe. Perhaps unwisely, Jack Straw, the British foreign secretary, said recently that armed conflict with Iran is “inconceivable”. The Europeans fear that an attack might persuade the Iranians to retaliate across the border in Iraq, as well as leading to a further spike in the oil price.

The China card

Whereas the Europeans believe they are taking the moral high ground over the Middle East and Iran, their position over China looks more like *realpolitik*. France is pressing for an end to the EU arms embargo on China and appears to be gaining support around Europe. The Americans are strongly opposed, and are lobbying their closest European allies—especially the British, Dutch and Scandinavians—to block any change. But EU diplomats seem to think that an intra-European deal is in the works, in which the embargo might be lifted at the same time as the EU tightens its code of conduct on arms sales, a measure that would supposedly rule out the sale of weapons that could be used to attack Taiwan or to repress human rights.

Such a move would confirm a willingness by the EU consciously to take decisions that the Americans consider to be contrary to their strategic interests. If a pattern of such decisions were to emerge, it would mark a real rupture in the western alliance. Powerful forces still pull in the other direction. NATO (and thus the Americans) has infinitely more credibility as a guarantor of security than the EU; this matters to countries such as Poland or the Baltic states that still worry about the Russians. Success in Iraq would also do a huge amount to restore American prestige in Europe and to rekindle the allure of Atlanticism. But failure could strengthen the siren appeal of Chirac-lite.

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Correction: Jozias van Aartsen

Nov 18th 2004
From The Economist print edition

Because of an editing blunder, last week's issue described Jozias van Aartsen as a Dutch Christian Democrat. He is of course the VVD (liberal) party's parliamentary leader. Sorry. This error has been corrected online.

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Public health

For richer, for poorer

Nov 18th 2004
From The Economist print edition

The government's public-health strategy is really about economics and class

“IN THE case of nutrition and health, just as in the case of education, the gentleman in Whitehall really does know better what is good for people than the people know themselves.” It was Douglas Jay, a minister in the post-war Labour government, who wrote those words; but it might as well have been Tony Blair or his health minister, John Reid.

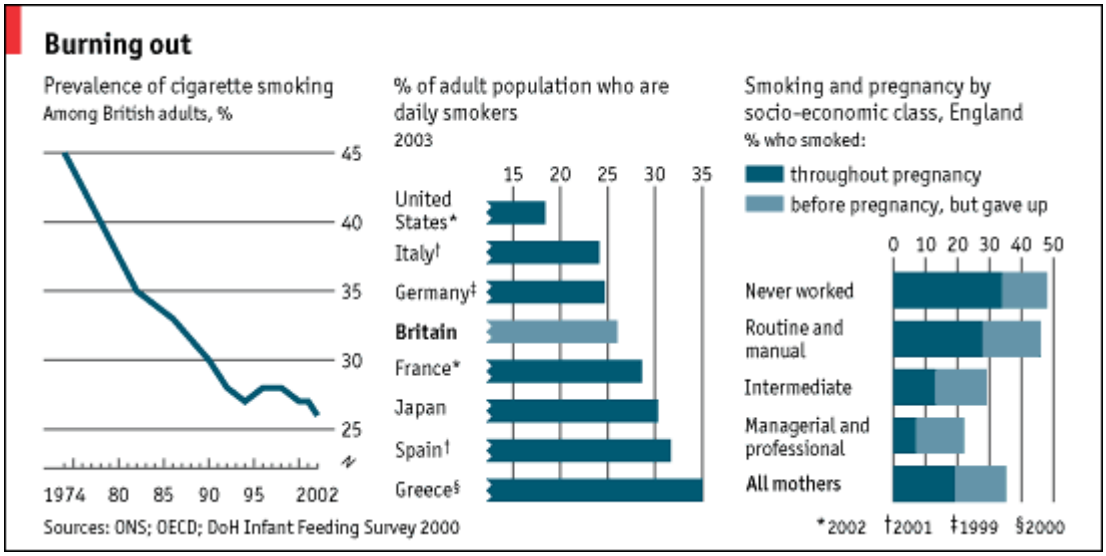
Mr Reid says that the government's proposals on public health, published on November 16th, are designed to promote “informed choice”. But the centrepiece of the white paper is a ban on smoking in most public enclosed places. The government is also seeking to curb television advertising of junk food and drink to children, and wants to use the National Health Service to cajole patients into healthier behaviour. The NHS, which already employs 1.3m in England, will hire “health trainers”—instantly dubbed “lifestyle gurus”—who will advise people on how to mend their ways.

One reason for the new strategy is money. The government is pouring cash into the NHS at the moment, but the spending spree is due to end in spring 2008. The new measures will cost around £1 billion ($1.85 billion) over three years. But Mr Reid told the House of Commons this week that “many times that amount will be saved”.

Such potential savings arise from the strong link between behaviour and health. This has long been recognised. In his classic text “Who Shall Live?” published 30 years ago, Victor Fuchs, a health economist at Stanford University in California, wrote that “differences in diet, smoking, exercise, automobile driving and other manifestations of ‘lifestyle’ have emerged as the major determinants of health.”

Since then, a lot of the improvement in life expectancy in Britain has resulted from a decline in smoking. Thirty years ago, 45% of adults smoked, now the rate has fallen to 26%. This has contributed to hefty declines in death rates from lung cancer and coronary heart disease in the past decade.

However, the decline in smoking has levelled out since the early 1990s (see chart). And other changes in behaviour are likely to undermine health. In particular, Britons are becoming fatter. In 1980, 8% of women were obese; in 2001, 24% were. Worryingly, children have also been getting fatter. In 1995, 9.6% of children aged two to ten were obese; by 2002, this had risen to 15.5%. If these trends continue, more and more people will develop diseases such as diabetes, both threatening the prospects for further gains in life expectancy and pushing up the cost of the NHS.



But it is not just the prize of better health at low cost that inspires the public-health strategy. The policy is also designed to reduce persistent health inequalities. Male life expectancy at birth for Britain's top social class was 7.4 years higher than for the bottom social class in the late 1990s. The gap has widened since the early 1970s when it was about 5.5 years.

The link between health inequalities and behaviour is manifest. Smoking is now concentrated among lower social groups. For example, 42% of male unskilled workers smoke, compared with 15% of professional males. Research suggests that such differences in smoking rates account for more than half the difference in male mortality between the top and the bottom social classes.

As people get fatter, another class divide is opening up. Some 28% of women in the bottom social class are obese—twice the rate among those in the top class. Obese children, especially girls, are more likely to come from lower social groups, which also eat about 50% less fruit and vegetables than professionals do.

For a government that is sensitive to accusations that it has pandered to the middle classes and done too little for the poor, such dramatic inequalities look like an opportunity. But observing that there is a large gap between the poor and the well-off is a lot easier than reducing it.

Even banning smoking in public places won't achieve that much. The government estimates that it will lead to a fall in the smoking rate of about 1.5 percentage points—way short of its goal to reduce the national rate from 26% to 21% by 2010 and the rate among routine and manual workers from 31% to 26% over the period.

Changing diet may be even harder. The government wants restrictions on television advertising of foods and drinks that are high in fat, salt or sugar. But Ofcom, the communications regulator, says that television has “modest direct effects on children's food choices”, so such curbs are unlikely to have much impact.

Attempts to prod people into healthier lifestyles—whether by nurses, doctors or the new “health trainers”—are also unlikely to produce quick results. For example, research into such interventions for alcohol abuse shows only “small to medium” effects six months later.

Habits take a long time to change. Yet the health of the poor has improved in the past decades, and will continue to do so. Where the rich lead, the poor will eventually follow; and government chivvying probably encourages them along.

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Education

Lock up your daughters

Nov 18th 2004
From The Economist print edition

The government wants more single-sex schooling

Get article background

DERIDED for decades as stuffy and out-dated, girls' schools are suddenly feeling more cheerful. They have long said that single-sex teaching brings better results. Now they are gaining allies. America this year relaxed rules that largely prohibited single-sex teaching in public schools. In Britain, David Miliband, the minister for schools, told a meeting of 200 private girls' school heads this week that the evidence for separate teaching was “startling”.

Freedom from the caustic scrutiny of the other sex seems to benefit not only girls, who are more likely to choose and do well in maths and science in single-sex schools, but also boys, chiefly in languages: fumbling French in front of girls, who are often better linguists, bruises the tender teenage male ego.

Mr Miliband cited a Cambridge University study of a school that started single-sex teaching in these subjects. In 1997, 68% of pupils gained five good passes in the GCSE exams taken at 16; by 2004, 81% of boys and 82% of girls had reached that level.

Mr Miliband's urging may mean a bit more single-sex teaching for some. State schools in Essex and Glasgow have already started limited trials of single-sex teaching. But neither statistics nor economics suggests a change back to single-sex schools.

That's because the overall picture is less clear than the “startling” case studies. The excellent results of single-sex schools may be because the schools are good, not because they are single-sex. The strongest predictor of good results is ability (measured by scores in previous exams) followed by parental background. What kind of school you go to comes third. A study by the National Foundation for Educational Research showed that, stripping out other factors, single-sex state schools seemed to raise GCSE scores by 1 point—the equivalent of one better grade out of eight exams taken. That's nice, but no panacea.

Alan Smithers of Buckingham University suspects other factors are at work. First, the case studies may be flawed because any kind of innovation often brings a brief improvement, perhaps simply thanks to paying attention. Second, single-sex state schools are more likely to be old-established and well run. Third, parents who choose single-sex schools for their children may also be the kind who provide other performance-enhancing features such as breakfast, early nights and a quiet place to do homework.

Whatever the academic argument, there may be other reasons why some parents and pupils want single-sex education, and there is a strong case for providing at least some of it in the state sector on choice grounds alone. The head of one east London girls' school says single-sex status means that traditionally-minded Muslim parents keep their daughters in school for two more years.

But there are disadvantages too. In particular, single-sex girls' schools struggle to offer as much to older pupils. Timetabling lots of subjects, and including rare ones, like further maths or Russian, is hard in the small sixth forms often found in all-girls schools. Some of the richest private schools manage it: many of the other ones don't. So some of their brightest girls move at 16, either to the co-ed sixth forms that private boys' schools have mostly introduced, or to mixed sixth-form colleges in the state system.

Even if the advantage of separate teaching in some subjects, for some pupils, at some ages, becomes an accepted fact, the trend is still co-educational. Some independent girls' schools now admit boys to their sixth forms, or, as in Sheffield in northern England, are creating hybrids with nearby boys' schools. Such

models keep single-sex schooling until 16, with mixed classes thereafter. That may be a wise compromise between market forces and ideology. For most girls' schools, the main goal of the sex war is still survival.

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Foxhunting

Going, going...

Nov 18th 2004
From The Economist print edition

After seven years of argument, a bloody sport looks close to death

Not yet gone to ground

OVER 400,000 people marched through London, protestors invaded the floor of the House of Commons and blood was spilt outside it. None of it worked: as *The Economist* went to press an ancient and colourful sport looked like being banned. The imminent ban on hunting with dogs, which followed a long row between MPs and peers, shows Britain's constitution at its crankiest and Tony Blair at his most cynical.

The prime minister has avoided most of the previous votes on hunting. This time he voted for a compromise, which would have allowed some hunting to continue under a licensing system, as in Scotland. But although usually proud of his powers of persuasion, he made no attempt to change the minds of Labour MPs, who almost all favoured a total ban. Mr Blair's resolution was so weak that half his cabinet voted against him. Now the Parliament Act, an emergency provision for forcing rules on to the statute book against the will of the House of Lords, will be used for a trivial law that is not even government policy. Why has Mr Blair let this happen?

Part of the answer is that Mr Blair conceded the foxhunting vote at a moment of political weakness, earlier this year. This allowed the Parliament Act, which can only be used when the House of Lords has rejected the same bill in consecutive parliamentary sessions, to come into play now. Banning foxhunting was an easy way for Mr Blair to show he was still close to his party, after 71 Labour MPs had voted against the government on university tuition fees, and even more were mumbling about lack of public trust in their leader.

Labour MPs seem happy with the deal; for once it is they who have persuaded Mr Blair into doing something that he didn't believe in, rather than the other way around. This impression could be misleading, though. One minister says Mr Blair has been quite happy to see hunting go, ever since marchers carried placards attacking him two years ago.

Hunters still believe their sport might be saved by constitutional wrangles. The Countryside Alliance, a lobbying group, is preparing to challenge the ban under human rights law. It argues that the lack of compensation for property lost is illegal.

But the Alliance is also planning a second, more colourful challenge. It argues that the 1949 Parliament Act is unlawful too, because it was rammed through the Lords using an earlier version of itself, the 1911 Parliament Act. Some experts think that using an Act to amend its own terms is unsporting, though, as ever with the British constitution, no one really knows. If this is true, three important laws—on the age of consent, voting in European elections and war crimes—will also have no legal basis. The Countryside Alliance has hired Sir Sydney Kentridge, a lawyer famous for attempting to prosecute police in South Africa for murdering Steve Biko, a black anti-apartheid activist.

Even if these arguments fail, the ban will be hard to enforce. Riding around with dogs won't be illegal—and they may “accidentally” kill a fox or two. Some 50,000 people have already signed a declaration promising to break the law rather than leave foxes alone. The government may have run its quarry to earth, but it has not yet killed it.

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Computer games

Party games

Nov 18th 2004 | NEWBURY
From The Economist print edition

Socialising for the wired generation

AT FIRST sight, the 500 young men lugging desktop computers into Newbury Racecourse last weekend looked set for a dull conference or trade fair. But this was a party. Revellers paid the £75 ($140) entrance fee, linked their computers together, and got on with boozing, laughing and blowing each other up.

Known as LAN (Local Area Network) parties, such events have grown fast. Craig Fletcher, managing director of Multiplay, the organisers of the Newbury event, says that his first party, in 1994, attracted 20 people. The record, set earlier this year, was an attendance of 1,200. Interactive Gaming UK (IGUK), a trade association, has 95 gaming centres—small shops that rent time on their computers—on its books, and is adding new ones at the rate of three a month.

Given that the internet offers thousands of free servers for gamers, why pay to go to a real-life knees-up? For a hobby often seen as anti-social, the answer may be surprising: it offers a chance to meet other gamers. The Newbury bash included off-line events such as a pub quiz, drinking games and a poker evening. “The analogy I like to use is pubs and off-licences,” says Dominic Mulroy of IGUK. “People like to drink at home, but they also like to go out on Saturday night and drink with their friends.”

So the idea that computer games are the province of socially-awkward teenagers is a preposterous calumny. Mr Fletcher says that most of his customers are aged 18-30, with professional jobs and, often, families of their own. And, like most people, they want to meet people like themselves.

About 50,000 of them took the opportunity to do so this summer, when London hosted Game Stars Live, an event halfway between trade fair and games party. Gamers were treated to pop concerts and scantily-clad PR girls, and the event was covered on television and KISS 100, a trendy radio station.

Businesses outside the IT industry are beginning to notice the advertising opportunities that such events offer, too. Alongside traditional sponsors like Intel (a big computer-chip company) and ATI (a maker of graphics chips), next year's European Online Gaming Championship will be sponsored by Chevrolet, a GM car brand.

What does the future hold? “Eventually, we want to be like Korea,” says Mr Mulroy. There, watching people play computer games is a mainstream national pastime. Whole television channels are dedicated to covering matches; big games can attract tens of thousands of spectators. The best players are nationally recognised.

Britain lacks such cyber-celebrities, but last week a top British gaming team began holding public try-outs, hoping to find a new member to compete in a gaming competition with prize money of $1m. Some 130 hopeful gamers signed up. With such rich pickings on offer, geekdom has never looked so glorious.

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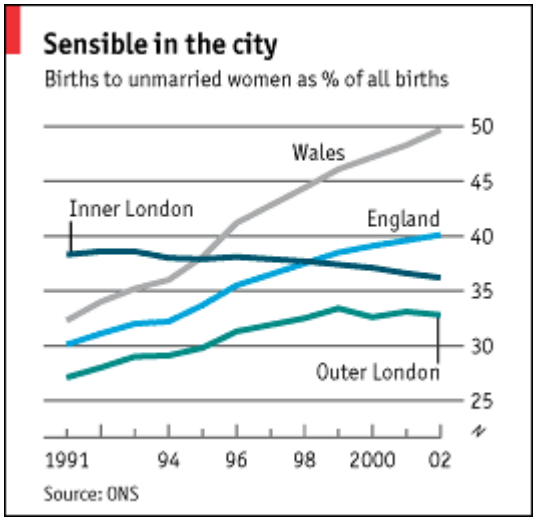
Marriage and parenting

Urban family values

Nov 18th 2004
From The Economist print edition

Unmarried parenthood is fashionable everywhere but London



PICTURE a traditional family—married parents, a few children, perhaps a bounding canine. Then imagine this old-fashioned unit in a corner of London such as Camden or Tower Hamlets. If the notion seems improbable, that is the result of centuries of propaganda: London has been associated with decadent individualism, and the countryside with social decorum, since the age of Shakespeare. But the improbable is true: conservative family values are thriving in the concrete.

Since the early 1990s, the proportion of children born out of wedlock has fallen in the capital even as it has risen almost everywhere else in Britain. In 1991, inner London had a higher rate of extra-marital births than any region of England or Wales; now it is well below average. By this measure, London is now more socially conservative than the true-blue shires of Suffolk, Worcestershire, East Sussex and Kent. Even in Tunbridge Wells, home to Britain's mythic moralist, 32.6% of babies were born to unwed mothers in 2002—pretty louche, compared with the 20.5% rate in Tower Hamlets.

Why has London—the “great cesspool”, as Arthur Conan Doyle called it—left its wicked ways? One reason is ethnic turnover. Whites and Afro-Caribbeans have come to see marriage as optional (the latter notoriously so) but Indians, Pakistanis, Bangladeshis and black Africans tend to hold much more old-fashioned views. Immigration and higher birth rates enabled the more conservative second group to add 404,000 London members between 1991 and 2001, while the number of whites declined by almost the same amount.

Another possibility, says Marco Francesconi of Essex University, is that London is simply too expensive to permit individual parenting. Mothers living alone (who account for more than a third of all unmarried mothers) often live close to the edge, but more so in London than elsewhere. Council rents in the capital are now £14.07 per week more than the English average, while social landlords charge £10.60 more; in both cases the gap has increased since the late 1990s. And heaven help any lone parent who must pay market rent. For many, reckons Mr Francesconi, the sums work out better elsewhere.

In wealthy and mostly white urban boroughs such as Westminster and Richmond, illegitimate births are uncommon for a different reason. Simon Duncan, a University of Bradford sociologist who has interviewed many cohabiting parents, says that affluent Londoners, like most Britons, are likely to view marriage not as an essential precursor to parenting but as a lifestyle choice—“a social symbol of having ‘made it’ ”. They may not have traditional immigrant values, but they have money to flaunt on a non-essential ceremony. That turns out to be just as powerful an incentive.

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Children and politics

Now clear up that mess you've made

Nov 18th 2004
From The Economist print edition

Grand visions for child care and the reality of the Child Support Agency

ACTORS are often advised never to work with children or animals. This week the government could be embarrassed by both. While a ban on foxhunting promises legal challenges and law-breaking (see article), new policies on child care have been undermined by the mess at the Child Support Agency (CSA). Alan Johnson, the minister responsible, offered the scalp of its chief executive, Doug Smith, to an angry parliamentary select committee on November 17th. A report by Frank Field—an independent-minded Labour MP and ex-minister—details the extent of the failure.

The CSA was set up in 1993, with the aim of managing child maintenance payments from one parent to another when a marriage breaks up or a parent leaves. It is supposed to work out how much is owed and then make sure it is paid. Neither task has been done well. Only half of the parents dealt with by the CSA have paid their ex-spouses correctly. In a quarter of cases, no payment has ever been made.

Although the agency has the power to lock up non-payers and to confiscate their driving licences, it seldom does so. Steve Webb, the Liberal Democrat spokesman on work and pensions, says the CSA tends to leave “hard cases” alone. Instead, those mostly fulfilling their responsibilities have been hounded, creating unnecessary tension. The agency currently owes parents around £1.72 billion. Over £1 billion of this is deemed uncollectable.

All this was meant to change with a new £456m computer system, introduced in March last year and supplied by Electronic Data Systems (EDS), a company with a patchy record in government IT projects. But moving cases from the old system to the new one is taking so long that at the current rate it will not be finished before 2067. When cases are transferred, workers in the CSA say the new system is temperamental. Some 40,000 cases are currently stuck somewhere in, or between, the two systems.

Whose fault is this? The government blames EDS and has withheld some cash. But this lets the Department for Work and Pensions, which is meant to supervise the CSA, off too lightly. *Computer Weekly*, a magazine, says that the department has requested more than 2,000 changes to the system. Such tinkering makes it hugely less likely that the system will work.

As a result, parents with wayward ex-spouses have often had to do the CSA's work for it, supplying the agency with details and chasing payments. Some of them have proved very resourceful. One woman told the select committee that she believed her husband, a taxi driver, was earning more than he had declared to the CSA. To test out this hunch, she had started driving a taxi at weekends.

Even with a decent computer system, making sure that parents pay up is difficult. Mr Field suggests that the CSA's functions should be transferred to the Inland Revenue, which already has information about earnings. Payments could then be taken directly from a parent's income, making them harder to evade. But Tony Blair has ruled this out for the moment. Until the mess is fixed, the prime minister's wish to “ensure the best possible start in life for all our children” will sound hollow.

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Telecoms regulation

More of the same?

Nov 18th 2004
From The Economist print edition

There are problems with Ofcom's elegant solution for BT

TELECOMS regulation used to be simple in theory and difficult in practice. In Britain it has meant fostering competition in a market dominated by BT. However, as telecoms change from being a mainly voice business to one in which data are king, and as the network itself transforms from regular copper to broadband fibre, the way it is regulated must change, too.

On November 18th Ofcom, the communications regulator, published the second phase of its strategic review of the telecoms market. The report is open for comment until February; a final version will be published in the spring. The report did not recommend the break-up of BT, which Ofcom had signalled it was considering in April. Instead, it settled on a concept called “equivalence”. This means BT must act as if it were structurally separated even though it is allowed to remain in one piece: BT Wholesale, which runs the network, cannot give preferential treatment to BT Retail, the arm that markets services, and vice versa. Is this a better idea than the real split that Ofcom originally floated?

There are good arguments for a break-up. It would be difficult, but regulators would not have to keep a continual watch over the company. Big companies are often broken up when they persistently flout regulations or serially breach antitrust laws. America's trust-busters called for the break-up of Microsoft in 2000, but had to settle for telling it to behave better.

Break-ups can work either very well or very badly. Britain's energy industry was broken up in the privatisations of the 1980s and 1990s. The resulting competition has served consumers well. The separation of the rail network from train operating companies, by contrast, has not.

Ofcom decided that breaking up BT would be too difficult and cause too much upheaval. Moreover, it reckoned it would actually hold back Britain's goal of spreading new communications services. Even BT's rivals were not all that keen on a break-up. They prefer the devil they know to the competitive threat from a BT Retail free of regulation.

Ofcom reckons that equivalence, by sharpening competition, will temper BT's dominance without the need for direct regulatory intervention. The worry is that BT knows just how to run rings round the regulator: 20 years after privatisation, BT still controls over 80% of the market for network access. Prices for broadband access are higher and service is slower than in much of the rest of Europe.

BT, not surprisingly, quite likes the idea of equivalence. It says it needs regulatory certainty to justify investment to improve its network and that regulation should concentrate on where other firms “hook into” the network, not, as today, on the entire telecoms services market.

But Ofcom may find that it ends up doing more monitoring than it expects. This is because, at the same time as the new regulatory framework is being established, BT's network is undergoing radical change.

BT is building something it calls the 21st Century Network to replace its existing wires. Although the new network will let BT Retail sell advanced services (and even possibly win back some customers), it will also help the operator hang on to its wholesale business in the face of competition from alternative local access providers such as cable companies and, in a few years, wireless companies using spectrum Ofcom hopes to liberate.

Ofcom's report calls for more disclosure in how BT accounts for its relationship between its retail and wholesale divisions. But now that splitting up the company is off the agenda, it is not clear what Ofcom can do to force BT to play nicely if it decides to return to its bad ways. Equivalence sounds elegant, but

the danger is that it will mean more of the same.

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Public procurement in Europe

Jobs for the other boys

Nov 18th 2004
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The chancellor says British companies are badly treated in Europe

THE timing was perfect. On November 15th, a government-commissioned study by Alan Wood, boss of Siemens in Britain, described the difficulties faced by British firms competing in the vast market for European government contracts, estimated to be worth 16% of European GDP. The next day Gordon Brown, the chancellor of the exchequer, raised the matter at a meeting of European finance ministers.

The report does not criticise the rules governing public procurement, but points out just how easy it is to evade them. British firms, it says, have to contend with everything from cultural bias and difficult regulatory conditions to state subsidies for competitors and outright corruption.

Methods for dodging the rules are as varied as they are creative. Contracts above a certain value must be put out to tender by law, but one particularly ingenious government got round this by splitting a road-surfacing job in half—creating separate contracts to surface the top and bottom layers of the road. Often, foreign firms are invited to bid only to push down the prices offered by domestic companies: there is no intention of actually granting them the contract. Many firms have complained that, while collusion between foreign firms and governments shut them out, the British government was happy to give contracts to those same foreign firms.

Because it is very hard to prove that a company has been treated unfairly, almost all of the evidence in the report was anecdotal. But it notes that only a sixth of available contracts are advertised in the *Official Journal of the European Union*, the relevant gazette. Direct cross-border trade with the public sector is only 10% of the total, compared with 20% in the private sector.

The European Commission, which is responsible for the public procurement rules, accepted the idea that the market was flawed, but said, rather frostily, that it had no evidence that British firms suffered any more than those in other countries. Complaining that it had been left out of the consultation process, it muttered darkly about the chancellor's long-standing tradition of anti-European remarks. Rubbish, said a spokesman for Mr Brown, pointing out that the report had been written after a public consultation to which the commission could have contributed. Yet the commission and Mr Brown could be natural allies: both want to see the rules enforced more stringently.

Partly, the spat reflects genuine frustration on Mr Brown's part with the glacial pace of liberalisation in much of Europe. But domestic politics may also play a role. As Mr Brown knows, Britain's Eurosceptic public likes to see its ministers doing battle with the perfidious continentals. But politicking aside, both sides agree that the market needs reform. There's no suggestion that Britain should retaliate by protecting its own companies. The commission estimates that competition for government contracts can cut prices by as much as 30%. So the British taxpayer, if not the British businessman, has reason to cheer.

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Bagehot

Let's all agree with Labour

Nov 18th 2004
From The Economist print edition

Child-care policies show how Labour thinks it's going to make its mark

AS THE government prepares for a May election it is confident of winning comfortably, both the Blair and Brown camps are united on one thing: the historic opportunity of a third term with a big majority must be used to “embed” policies that permanently change British society.

At first sight, this ambition sits uncomfortably with a government characterised (at least in domestic affairs) by caution and dislike of ideological conflict. But Tony Blair and Gordon Brown are both frustrated men. New Labour, they believe, has not received enough credit for its achievements: successful stewardship of the economy; rebuilding broken public services; making headway in tackling the worst pockets of poverty; electoral hegemony. Yet they would also both reluctantly concede that in comparison with the post-war Attlee government that founded both the welfare state and the National Health Service, or the Thatcher government, whose microeconomic reforms restored Britain's prosperity and standing in the world, eight years of New Labour have not left much of a mark.

Although both the Attlee and Thatcher governments eventually succumbed to exhaustion, their political opponents had to accept their settlements as a condition of coming to power. Indeed, until the arrival of Margaret Thatcher as Tory leader, it was generally believed that a “ratchet” effect in British politics had embedded Labour ideas in spite of the greater electoral success of the Conservatives. It meant that Labour, during its usually brief periods in office, could introduce large, ideologically-driven changes, such as nationalising major industries in 1945-51 or abolishing grammar schools in 1964-70, that subsequent Tory governments were ready to live with.

Lady Thatcher's achievement was not just a partial reversal of Labour's ratchet, but its replacement with one of her own. To have a chance of coming to power in 1997, New Labour had to promise not to repeal Tory union laws, undo privatisations or raise marginal income-tax rates; and that commitment helped it secure a majority that would make it unassailable for years to come. New Labour thus implicitly promised the voters that, while it intended to make life better for poorer people, it would not do so at the expense of economic efficiency.

At least partly because of this, not many of the government's policies have changed Britain permanently. The exceptions are the minimum wage, Scottish and Welsh devolution, Bank of England independence and, at a pinch, the Human Rights Act. Pretty much all of that was initiated within the first year of Labour taking office. Some might claim that the abolition of hunting with dogs and the partial ban on smoking in public places will change society and will not be reversed by future governments. But Mr Blair is uncomfortable about the former, while the latter is essentially legislative underpinning for something that was already happening.

Apart from its first radical year, New Labour's mode of operation is not to do first and hope to convince later, but patiently to build a consensus to get permission for the things it would like to do. In contrast with its Labour predecessors, its strategy has been to stay in power long enough to achieve its aims through gradualism and consolidation. Before pouring money into the NHS, the government waited until it was sure it had made the case for doing so. The Tories criticise the government for the way it is trying to run the NHS, but they don't dare to question the lavishness of the spending. The consensus in favour of a well-funded NHS will be difficult to shift.

In his speech to the Labour conference two months ago, Mr Brown used the expression “progressive consensus” 12 times. That phrase, or something very close to it, routinely crops up in the prime minister's speeches, as well as those of Alan Milburn, who was recently brought back to frontline politics by Mr Blair to take charge of drawing up the election manifesto and planning the campaign. New Labour's

claim is that its own “progressive” instincts are increasingly those of the majority. What's more, it actually thinks it's true.

Suffer the children

One result is that the government's implementation of its social justice agenda, which in the past has been so stealthy as to suggest embarrassment, is becoming more explicit. In recent months, ministers have been talking a lot about the need to reverse declining social mobility and the entrenched inequality and poverty that is the result of it. The sharpest example of how the government intends to forge its “progressive consensus” is the panoply of schemes for children and childcare that the prime minister announced last week and which are destined to be a centrepiece of the manifesto.

These policies are driven by the belief that what happens in the years between cradle and primary school determines a child's chances in life and that the children of feckless parents must therefore be rescued from their fate. However, while the underclass is the real target, the government knows it must also entice the “hard-working families” it goes on about with subsidised nurseries, schools that stay open from dawn to dusk and longer leave for new parents. Even the childless should benefit if such policies leads to safer streets and fewer anti-social-behaviour orders.

It took the Tories 25 years to work out how to reverse the socialist ratchet. But, in some ways, New Labour's progressive consensus is potentially even more threatening to them. At least the previous ratchet was compatible with long periods of Conservative government. But if Mr Blair and Mr Brown are right—and with the Tories flatlining in every poll and election since 1992 at about 30% they could be—there may not even be that consolation for the Conservatives.

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China's media

Please adjust your set

Nov 18th 2004 | HONG KONG AND SHANGHAI
From The Economist print edition

China's plans to modernise its media and attract foreign investment will open up new ways to reach its millions of consumers

SCANTILY clad models strut their stuff as the audience leers, whistles and chooses the hottest looker. What sounds like just another cheesy American TV game-show is, in fact, something rather new: a cheesy Chinese TV game-show. And that is not the only thing new about the show. In “Women in Control” the contestants are men and the judges are women. But even more surprising is that, in a land of propaganda films and bland melodramas, the censors are allowing it to be aired at all.

The show, made by Star TV, the Asian arm of Rupert Murdoch's News Corporation, is testament to China's attempt to modernise and rationalise its sprawling media industry, and to bring in foreign money and ideas. This week, the Chinese government was due to announce more details about its loosening of the rules.

The overhaul is badly needed. China has over 2,000 newspapers, some 9,000 magazines and 568 publishing houses, according to the State Administration for Industry and Commerce (SAIC), reflecting the practice of every ministry and party body to maintain its own mouthpiece. More than 700m Chinese listen to 1,000 radio stations, while 200 TV stations broadcast 2,900 channels. China Central Television (CCTV), the state broadcaster, claims an audience of over 1 billion people. Outdoor advertising is taking off and so is e-commerce, with 87m internet users.

Yet Chinese media have long been loss-making due to their propaganda role. Advertising spending on TV, radio, print and outdoor, although growing fast, was still less than $7 billion for 2003—tiny when compared with America (see table). China's state broadcasters are heavily subsidised and its myriad government newspapers are financial burdens on the institutions that control them and on readers traditionally ordered to subscribe to them.

The government is determined to eliminate losses by attracting more advertising and more paying users. Referring to CCTV, “China realises that the mouthpiece of the Communist Party can

contribute to GDP," says Jamie Davis, president of Star TV in China. Policymakers now recognise that unless Chinese media can win and hold viewers and readers they will ultimately be unable to influence public opinion.

Rationalisation is part of the strategy. Earlier this year, more than 1,400 state and party newspapers and periodicals were shut down, merged with commercial groups or forced to finance themselves. At the same time, the government is promoting—as in other industries—the creation of national champions. "China is ultimately determined to turn itself into a global media power," says David Wolf, a media analyst in Beijing.

Billions to play for

Advertising revenue by sector, 2003, $bn

	United States	China
Newspaper	45.5	2.9
Television	43.3	3.0
Radio	19.5	0.3
Magazines	12.4	0.3
Internet	7.3	0.1

Sources: Interactive Advertising Bureau; International Data Corporation; State Administration for Industry and Commerce in China

The most obvious candidate for this role is CCTV, which accounts for one-third of ad spending on TV. Restructuring plans announced in February could mean it spins off some production units and channels into independent subsidiaries listed on the stockmarket. CCTV-5, its successful ten-year-old sports channel, could be the first. But it will be beaten to the punch by the *Beijing Youth Daily*, which is planning the first flotation of a mainland paper—though only its commercial operations—by the end of the year. Xinhua Financial News, a news-wire venture owned by Xinhua, the state press agency, was recently floated in Tokyo, while the rival Shenzhen Press Group is also eyeing a listing. China's three big internet portals, Sina, Sohu and Netease, have already been listed on America's Nasdaq exchange.

While CCTV's gradual reform remains controversial among the party leadership, there are no constraints on the state-owned Shanghai Media Group (SMG), which is expanding fast and attracting foreign partners. Its president, Li Ruigang, has assembled a multi-media smorgasbord with 12 TV channels, 11 radio channels, an internet portal, six sports teams and artistic groups including Shanghai's symphony orchestra. It had combined revenues of $290m last year. Newspapers are next. On October 18th, the group announced a partnership with *Beijing Youth Daily* and *Guangzhou Daily* to create a daily financial newspaper in Shanghai. "Shanghai will now have a business flagship daily just like New York and London," says Mr Li. Vivek Couto, an analyst at Media Partners Asia in Hong Kong, predicts that "in a decade, SMG will be a global Asian media company."

China's media also need modern infrastructure. Radio and TV are already nearly universal, helped by 100m cable-TV subscribers. Personal computer use is spreading quickly. The next step is digital TV, with the State Administration of Radio, Film and Television, the broadcast regulator, aiming to have 30m digital-TV subscribers by 2005. It plans to move all programmes to digital by 2015.

But none of this is any good without compelling content. Chinese people not only distrust their official media, but they are bored by it. The evening news on CCTV-1 still drearily starts with public appearances by senior leaders. And the front pages of the big three party newspapers, the *People's Daily*, *Worker's Daily* and *China Youth Daily*, often mirror each other.

Enter the foreigner

The need for new content and technology is driving Beijing to open its media sector to foreigners. Germany's Bertelsmann had a head start with its mainland book clubs in the 1990s. America's IDG, another pioneer, has a profitable magazine-publishing business. News Corp, Viacom and Time Warner have limited TV broadcasting rights in southern Guangdong province. Further deregulation will benefit these companies most, especially the removal in December of a ban on foreign investment in production companies.

Viacom (which owns Nickelodeon) has signed the first joint-venture TV deal: to produce children's programming in Mandarin with SMG. Last month, Warner Brothers announced the first foreign joint venture to produce films in China, which still restricts the import of foreign movies. Advertising groups have more than 330 foreign-invested agencies in China. In June, Britain's WPP was the first to buy a majority stake in a big local agency.

But progress is mostly painstakingly slow. While Charles Chau, vice-president at MTV Asia, an arm of Viacom, enthuses about China's "huge opportunities", the SMG-Viacom venture has yet to get final approval, despite multiple visits from Viacom's chairman, Sumner Redstone, to Beijing (though SMG's Mr Li says approval is imminent). Time Warner got so fed up with its loss-making TV joint venture in

Guangdong that it sold out last year. And in radio, increasingly attractive because of its cheap ad rates, growing audience (with rising car ownership) and reach into rural markets, the biggest deal has already fallen through; Virgin Radio Asia recently abandoned plans for a station in Beijing after its Chinese partner suddenly raised the cost.

Local, privately owned firms—often run by Chinese returning from overseas—are changing the media landscape more quickly. Hung Huang has created a stable of profitable glossy lifestyle magazines, such as *Time Out*, *Seventeen* and *i-Look*, which cater to China's newly wealthy and so attract luxury-goods advertising. However, a slew of copycats are undermining profits and editorial integrity. Ms Hung now thinks selling content to radio and TV might be more lucrative. Yu Lei, managing editor of *Shanghai Tatler,* says that competition between lifestyle magazines is now so stiff (there are 40 such titles in Shanghai alone) that clients demand several pages of “advertorial” for every ad they buy. That, together with a lack of proper research, ratings and audited circulation figures, means advertisers are limiting or even cutting their spending because they cannot be sure they are reaching the right audience. And distribution remains the severest constraint of all. Ms Hung hires people to deliver by bicycle.

If print is overcrowded and its content compromised, the prospects for pay-TV are hardly better. China's cost-conscious consumers are reluctant to pay premium rates for new channels, especially with state-run channels improving things, like their foreign reporting. Meanwhile, cut-throat competition among cable operators has driven down subscription rates. And millions get foreign broadcasts for nothing through illegally owned satellite dishes. CCTV launched its first pay TV package in August, but the uptake has been “tiny”, says Star TV's Mr Davis.

Ultimately, of course, the main obstacle to the rapid development of China's media remains political. Despite the rise of critical websites and investigative periodicals, such as *Caijing* in Beijing, China will not risk losing ideological control. The editor of the feisty *Southern Metropolitan Daily* was arrested recently on trumped-up charges after reporting too freely on the SARS epidemic. Local newspapers receive faxes from the propaganda ministry listing stories on which reporting is banned. The State Council's Information Office, another censorship body, controls everything from the colour of the hair dye used by TV presenters to internet postings.

Much of China's recent openness may be more apparent than real. The central government has indirectly encouraged exposure of corruption at lower levels, tolerating a degree of media criticism as a safety valve. Recent moves to hold more press conferences at provincial and city levels, far from signifying more openness, are a way to get the official version of events into newspapers.

Moreover, domestic pressure for further freedoms appears limited. Even Xi Shugang, editor-in-chief at the group which publishes *Caijing*, sees a need for censorship: “China is developing very unevenly, between rich and poor. The government has to maintain a stable situation.” Foreigners, meanwhile, will be welcomed for their capital, technology and creative skills, but kept away from sensitive areas such as news. China's media may be increasingly vibrant, but it is a long way from being open.

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American retailers

In the wake of Wal-Mart

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From The Economist print edition

Two struggling American retailers seek salvation together

CAN Edward Lampert prove he is more than a glorified asset-stripper? On November 17th Kmart, a struggling retailer controlled by his much-feted hedge fund, ESL Investments, said it was merging with Sears Roebuck, another tired American retailer, in a deal worth about $11 billion. The new company, called Sears Holdings, will become America's third-largest retailer, with annual sales of $55 billion. Mr Lampert has already established a sharp eye for undervalued assets and a talent for squeezing cash from them. He will now be keen to show sceptics that he also knows how to run a company.

Mr Lampert amassed his 53% stake in Kmart as it emerged from bankruptcy-court protection in 2002-03. It was a shrewd investment. Even as Kmart's sales plunged, Mr Lampert's managers cut overheads, inventories and capital expenditures, and raised $3 billion by selling off some choice properties to rivals, such as Home Depot and Sears. “Eddie has done a masterful job of squeezing every cashflow dollar possible out of Kmart,” says Darrell Rigby of Bain & Company, a consultancy. When in October he hired Aylwin Lewis, a PepsiCo veteran, to run Kmart, Mr Lampert appeared to signal the company would return to growth: its same-store sales have been shrinking at 13% a year.

ESL Investments also owns, at the last count, 13.5% of Sears. This once-proud department-store chain found itself on the wrong side of every big trend reshaping American retailing. It was slow to recognise the threat to its shopping-mall department stores from out-of-town “big-box” discount chains, such as Wal-Mart. It failed to appreciate the convenience they provide customers by stocking groceries as well as household goods, clothes and electronics. It may also have failed to understand quickly enough that the best way to compete against Wal-Mart might not be on price, but with a more upmarket and appealing selection of goods, as successful retailers such as Costco and Target do.

Over the years, Sears's shareholders have learned not to expect much from the company's benighted management. Even so, the firm's boss, Alan Lacy, whom Mr Lampert will keep as chief executive, has managed to disappoint. He has twice cut the firm's miserably low profit forecast for this year. Sears's share price has rallied recently, but only because Vornado Realty Trust, an investment fund which buys struggling retailers for their property, said it had taken a 4.3% stake in the company. Like Kmart, the pieces of Sears appear to be worth more than the whole.

Some savings can be made by combining certain operations. Yet, says a retail consultant close to both companies, “if this is only about cost, it's not going to work.” Even after the merger, Sears Holdings will be less than a quarter of Wal-Mart's size and still lack its clout. Sears had been trumpeting the happy prospects for its new, big-box retail format, called Sears Grand, which offers groceries as well as household goods and clothing. Mr Lacy had been planning to convert the 50 shops which Sears bought from Kmart into this new format. Now that strategy will accelerate, says Sears, as it converts more of Kmart's “off-mall” shops into new Sears.

Meanwhile, some of Kmart's stronger brands, such as its Martha Stewart Everyday products, will help with the strength that Sears has traditionally enjoyed with some of its own brands, such as its Craftsman tools and Kenmore refrigerators and cookers. This could help to protect Sears from Wal-Mart's relentless discounting.

Some of Mr Lampert's erstwhile supporters had been hoping he would squeeze Kmart for its remaining cash, wind the company down and take his billions to invest elsewhere. Such hopes helped to boost shares in Kmart nearly fivefold this year. Indeed, there is some speculation that he may try to position Sears Holdings as an investment vehicle, rather like Warren Buffett's Berkshire Hathaway. By doubling his bets in retailing, Mr Lampert has, in effect, declared that just like his hero, Mr Buffett, he too wants to

manage his companies for the long term. He has his work cut out with the “Beast of Bentonville”, as Wal-Mart is known, breathing down his neck.

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The music industry

I want my P2P

Nov 18th 2004
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Record labels are trying to do deals with file-sharing networks

Get article background

MAJOR record labels have spent years fighting tooth and nail, through courts, legislatures and on the airwaves, to destroy music file-sharing networks on the internet. But they now seem to have accepted that they cannot stop people using such networks and have decided instead they may as well find a way to profit from them.

Universal Music Group, owned by France's Vivendi, is reported to have struck a deal to license its catalogue to a new firm called Snocap, run by Shawn Fanning, who founded Napster, the first big file-sharing network. Snocap's technology would allow Universal to recognise songs swapped on a network and send its users a bill—if the service agrees to embed the software. Sony-BMG is in talks about a similar venture with Grokster, another so-called peer-to-peer service. The aim is to woo people into paying for music which they have been downloading for free.

If it works, the recorded-music industry could reverse its falling sales. But what is in it for file-swapping sites like Grokster, eDonkey, or Morpheus? A respite from music-industry lawsuits is the main draw. File-sharing networks also want the music industry to stop “spoofing” them with fake files. And they, too, are not averse to making more money from their users, who spend little now.

Both sides will claim a moral victory once more deals are announced in the next few months. Music companies will boast that they have turned the networks into law-abiding corporate citizens. The peer-to-peer community, on the other hand, will argue that the music industry has finally recognised that file-sharing is a powerful promotional tool that does not stop people buying the music they really like.

The reality is likely to be a compromise. The file-sharing networks cannot force people to pay for everything they download without driving users away to free services. An attractive offering must still have lots of free content to share as well as stuff that has to be paid for, says Sam Yagan, boss of eDonkey. Meanwhile the music industry continues with its global legal campaign against heavy individual file-sharers, with over 7,000 people already facing lawsuits. They may in future come to be seen as pioneers of a new business model—with unfortunately early timing.

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Controlling the internet

World v web

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America does not want the United Nations to run the internet

CONSIDER the differences: the global telephone system is co-ordinated by a United Nations agency; countries enjoy sovereignty over phone numbers, have national regulators and license operators. But the internet is managed by a non-profit organisation that reports to America's Commerce Department; national laws are hard to enforce and even suffixes (like .es for Spain) exist in a grey area. A fight is on over whether governments should manage the internet more closely.

The battle moves to Geneva on November 23rd for the first meeting of the UN Working Group on Internet Governance. Tensions are inevitable among the 40 recently appointed delegates. Many countries are dissatisfied with the way the internet's technical standards are set, the policy for things such as domain names and valuable internet-protocol numbers (used by computers to connect online).

Today, the system is run by the Internet Corporation for Assigned Names and Numbers (ICANN). The group was formed in 1998 by America with the help of business and the informal consent of other countries. Governments are represented by an impotent advisory committee.

Many countries complain that even though ICANN is expected to become independent in 2006, it will be placed on a private, industry-led footing rather than under the oversight of governments themselves. The UN group is thus an attempt to ease control of ICANN away from America and place the internet's underlying infrastructure on an intergovernmental basis, much like today's telephone system.

The business community, predictably, prefers the private-sector ICANN. It echoes the views of America, that this ensures that the internet's fast pace of innovation is not jeopardised by the politics and bureaucracy which typify UN agencies. Although the internet is decentralised and hard to control, the infrastructure that ICANN manages represents the few levers that governments have to impose control should they choose to do so. Also at stake is money: registering domain names generates about $1 billion annually, and assigning new domains—think .web or .sex—is a power over very lucrative assets.

Half the UN working group is comprised of government officials, and half from “civil society” organisations, academia and industry. It is charged with defining “internet governance” and recommending what the role of governments and international organisations should be (not a big mystery coming from a group convened by the UN itself). In addition to ICANN, the committee will look at general online issues such as spam, network security, cyber-crime and the cost of international telecoms bandwidth. The group's report is due before the second phase of the UN World Summit on the Information Society in November 2005.

Most countries oppose the current arrangement. China wants ICANN under the aegis of the UN, as do most poor countries. European countries once supported America's private-sector approach, but are now willing to accept a UN role. Brazil and others want an intergovernmental forum where a panoply of internet issues can be discussed, not just ICANN.

The central problem is that ICANN is seen as an expression of American unilateralism. Ironically, it was created as a way to internationalise internet technical management, but on a private, non-governmental basis. Until 1998 these tasks were done by an American computer-science professor under contract with the Defence Department—the last vestige of the internet's roots as a military research project. An autonomous ICANN grounded in the private sector is still unsatisfactory to other countries because they fear America's technological strength means it will dominate anyway, which is only partially true.

However, the uncomfortable reality for most countries is that American control of the internet's domain

name system and its spread through the private sector has contributed most to the development of the internet. Indeed, many of the countries in the UN working group—such as China, Cuba, Iran and Saudi Arabia—have created barriers to internet use, from filtering content to banning cheap internet calls. Despite ICANN's flaws, having these countries run the network isn't ideal either.

American officials say they “fully support” the UN process. But the country's conspicuous absence from the working group gives it leeway to distance itself from recommendations, or discredit it. Strikingly, the situation resembles the debates 30 years ago at UNESCO over the New World Information and Communication Order, when poor countries sought state accreditation of media and control over information. The dispute led America and Britain to pull out of the UN body in the mid-1980s, only to return later. If other countries push so hard for America to give up control of ICANN only for them to fill the vacuum, America's likely reaction will be to hold on to ICANN ever more closely. This fight will get uglier.

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The WTO and online gambling

House of cards

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Laws banning gambling show the strength of sovereignty

IN THE continuing battle between cyberspace and national sovereignty, the offline world has won—despite appearances to the contrary.

On November 10th, a World Trade Organisation (WTO) dispute panel published its decision that old American laws prohibiting gambling over wires that cross state lines violate global trade rules for the services sector. The complaint was filed by the small island-state of Antigua and Barbuda, home to internet gambling sites providing local employment. Eventually, it may be able to impose trade sanctions on America.

So, a jackpot for the internet? Not quite. It actually underscores the persistent ability of national law to trump internet activities, as well as the authority of offline treaty organisations to decide squabbles that take place in cyberspace.

For starters, America plans to appeal the decision, and has strong arguments. The WTO decision placed online betting in the category of “other recreational services”, which seems an interpretation at least open to question. Also, the 1995 WTO services agreement contains a provision that lets countries ban trade where it has national laws designed to “protect public morals”, which would seem to cover gambling, at least from a puritanical American perspective.

America's attitude, and the absence of activists storming the digital ramparts in defence of the net, does not just indicate the degree to which internet matters have matured: it reveals a slight double standard. In 2000, France was criticised for banning Nazi paraphernalia from the auction site of Yahoo!, based in California. But France basically did what America in this instance wants to do: uphold the primacy of national law.

Ironically, a case akin to the Yahoo! ruling—involving where jurisdiction exists online—was quietly settled last week. Dow Jones, an American publisher, was sued for defamation in Australia because an article it printed was available there over the internet. The Australian High Court ruled in 2002 that this was sufficient to claim jurisdiction. By extension, the decision means a website can be sued in any geographic location from which it is viewed. The ruling stands, even though Dow Jones settled the case before the merits were decided, by printing a clarification and paying some of the plaintiff's legal fees.

Taken together, the cases point to the degree to which governments are clearing up grey areas of internet-related law. It may not be the outcome cyber enthusiasts want, but how many divisions do they have, anyway?

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GM food

Soya on rice to go

Nov 18th 2004
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Brazil and China are set to legalise genetically modified crops

AFP

What have they done to my lunch?

Get article background

A DOUBLE blow is coming for the opponents of genetically modified (GM) foods, from two of the world's big farming nations. China, where many farmers already grow GM cotton, is likely soon to authorise commercial growing of GM rice. And Brazil is close to setting up a mechanism that could legalise all GM crops.

Brazil's farmers already plant lots of GM soya, especially in the far south where seed is easily smuggled in from Argentina. In theory this is illegal. But last month, well after planting had begun, it was authorised by presidential decree, as happened last year. The government knows it cannot enforce current law, and would face trouble if it tried. Instead, a bill to regulate GM crops has already passed the Senate and is now back with the Chamber of Deputies. These latter are not hurrying, since the bill also covers human stem-cell research, a far more contentious issue. But few doubt it will be passed. And because the GM regulators will be named by the ministry of science, their hand will probably be light.

The effects could be significant. Brazil is the world's second-largest grower of soya after the United States (where nearly all soya is GM). Brazil expects a huge soya crop, maybe 60m tonnes, in the new season, and up to a third could be GM. With long-term legality assured, that proportion might rise fast—and future harvests with it: the GM seed, derived from Monsanto's herbicide-resistant variety, does not in itself raise yields, but it does cut costs, making soya more attractive to plant.

Soya traders in Brazil face an opportunity and a problem. They will probably have more to export, and it will be welcomed by some markets. But new European Union rules require GM and non-GM crops, even if destined only for cattle-feed, to be kept strictly apart. The big traders, multinationals such as Bunge and Cargill, say this can be done, at a price. But many others have doubts, given Brazil's huge number of growers and the long supply chain. At best, it will be costly.

Such an obstacle to trade has given GM's foes one big victory this year: Monsanto stopped trying to sell a GM wheat, because North American farmers feared a loss of exports, both to Europe and Japan. But Chinese backers of an approval for GM rice turn that argument on its head.

Global trade in rice is small: only about 25m of the 400m-odd tonnes (in milled-rice terms) that the

world produces. And China's share is tiny: it grows nearly 30% of the world crop, but trades only 1m tonnes or so each way. So why worry, ask its GM scientists? China stopped growing GM tobacco a few years ago, for trade reasons. But if Japan and South Korea, its main rice-export markets, object to GM, so be it, say GM's backers: nearly all of China's growers and all its consumers will benefit.

China's rice bowl

Technically, China is well prepared. Its scientists have been developing GM rice varieties—mainly pest-resistant, but also herbicide- or disease-resistant—for years. And for three years now they have conducted “pre-production” trials, giving the new seeds to many farmers in diverse areas and leaving them to get on with it. So far, says Jikun Huang, director of the Centre for Chinese Agricultural Policy, the trials show pesticide use down by 80% and yields 4-8% up. The scientists are also conducting their own regional trials in Hubei and Fujian provinces, partly as a check on the farmers' results. The new harvest is just in, and if all has gone well, the scientists argue, why wait for still more trials?

A go-ahead is not certain. China's environmental-protection agency shares the standard doubts about GM; and in today's China, even unofficial environmental campaigners are not negligible. Greenpeace has been campaigning among farmers in Yunnan province against the new rice. And some agriculture-ministry officials see the present ban on it as a useful protectionist tool. Yet China's biosafety committee, due to meet soon, looks likely to say yes. One reason is the health of farmers themselves: in China, crop-spraying is not as safe as in richer countries. And consumers know and fear the risk from pesticide residues. Overall, Mr Huang says, a consumer survey done for his centre found 80% ready, at equal prices, to buy GM rice. Greenpeace offers a less creditable reason: some scientists on the committee, it says, have interests in firms set up by their institutes to develop GM varieties.

If the committee says yes, the final government decision would probably be the same. At which point, enter Monsanto? It would have the incentive. The new GM rice is all hybrid, so seeds can not be saved from one harvest to sow for the next (unlike GM cotton, whose Monsanto variety is widespread in China, but brings Monsanto few follow-on sales there). And all China's maize is hybrid, and much of its non-GM rice; so farmers are accustomed to buying fresh seed. Yet, in rice, China's scientists are ahead of Monsanto's.

The big effects could come in another way, argues Scott Rozelle, an economist at the University of California who has worked closely with Mr Huang. India's farmers, once they were allowed to do so, rushed to sow GM cotton. And India's scientists have plenty of biotech-rice skills. If its government, fearful of lagging behind China again, were to set both boffins and farmers free, India also might rush into GM rice. Brazil too, maybe: its new law will not apply only to soya. So quite soon big new rice supplies might be available for export—and the genie of GM food truly out of the bottle.

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Face value

A better way to fly

Nov 18th 2004
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Giovanni Bisignani's plans to make airlines more profitable should also please passengers

Landov

AS THE new director-general of the International Air Transport Association (IATA) approached the podium to speak at a big conference in Tokyo, a member of Japan's imperial family was swiftly ushered out, forewarned of looming embarrassment. When Giovanni Bisignani began to attack extortionate landing charges at Tokyo's Narita airport (the world's most expensive), the entire front row of government and industry dignitaries rose and also filed out. Undaunted, he continued to lay into the government for using the airport as a licence to print money.

That was two years ago, but Mr Bisignani still chuckles at the fuss. Though a former boss of Italy's cosseted Alitalia, he seems more the product of his education at Harvard Business School and stint at General Electric (GE) under Jack Welch than a creature of state-aided industry. He cares little for aviation's usual diet of waffle and diplomacy. He wants direct action and is interested in results—especially the sort of results that show that while suppliers such as airports and air-traffic-control services have operating profit margins of up to 33%, airlines have been lucky to make 4%. “We do the flying, and everybody else makes money out of us,” says Mr Bisignani.

Hence his bitter attacks on airports and other monopoly suppliers to airlines. While airline revenues-per-passenger have fallen 25% in the past decade, many airports have kept increasing charges to an industry already reeling from repeated shocks. With the effects of economic slowdown, terrorist attacks, the Iraq war and SARS wearing off, Mr Bisignani had been looking forward to his organisation's 270 members (the world's international airlines) making a collective profit of around $3 billion this year. But the rise in the price of oil has hit airlines hard. He now expects a $4 billion loss. One dollar on the price of a barrel of oil costs airlines another $1 billion, if sustained for a year. Airports used to negotiate with airlines every other year about whether rises in airport charges should be 5% or 10%. Now the discussion is over how big the reduction should be. And yet given the monopoly power of most airports, it is hard to make any headway.

In response, Mr Bisignani has turned IATA into an aggressive lobbyist. Formed during the birth of commercial aviation after the second world war, IATA for decades was the official cartel that fixed routes and fares with the blessing of governments. Having lost that role in the 1990s when the industry was opened to freer competition, IATA became mostly a talking shop.

Mr Bisignani called in Noel Tichy, the man behind GE's famous internal management academy, “to throw a bomb into the church”. When it went off, more than half the staff left. “I did not want professor types telling me what the future of aviation would be like,” says Mr Bisignani. “I wanted tough guys not diplomats.” One he hired was Jeff Poole, a former boss of purchasing at Europe's Airbus, who is now benchmarking the world's airports and other suppliers to help them cut their costs and, hence, charges, in a sophisticated form of naming and shaming.

Tough is working. As jet-fuel prices began to rise last year, IATA got airlines and governments together to re-design routes to make them shorter. In the old IATA this would have taken forever, with lots of bilateral discussions between neighbouring countries. Now Mr Bisignani gets everyone into one room to work out, say, the shortest route from London to Singapore, flying over borders to make a straight line, rather than the twists and turns of conventional airways. The result: 35 minutes off the flying time, saving each airline on the route $70m a year.

Mr Bisignani says such measures are only emergency fire-fighting compared with what he sees as his real job of dragging a complex industry into the 21st century and making use of more information technology. One objective is the abolition of paper tickets, replacing them with the sort of electronic or “e-tickets” that are used on some routes. Since each paper ticket costs an airline about $10 to produce, savings could reach more than $3 billion a year. Hitherto, e-tickets have been fine for simple flights, but complicated journeys involving transfer payments between various airlines will require a complete overhaul of IATA's back-office payment-settlement system, due to happen by 2008.

Thereafter it will be easier to transform the world's departure lounges, eliminating some hassle. When a flight is booked over the internet, the traveller will print out a combined ticket and boarding pass complete with a sort of bar code containing all necessary information. These will be slipped into machines in the departure hall, “rather like ATM machines and banks”.

Where's my bag?

Experts gathered this week at IATA's headquarters in Geneva for the first meeting dedicated to turning these ideas into reality. They will also discuss Mr Bisignani's campaign for airlines to adopt radio frequency identification devices (RFIDs) for checked baggage. This should cut the number and cost of lost bags. As supermarkets adopt RFID tags, their cost is falling to a few cents each, and Mr Bisignani is cajoling carriers to come up quickly with a common standard. Lost bags cost airlines nearly $1 billion a year and lots of customer goodwill.

But technology cannot solve everything. The biggest obstacle to a more efficient industry is the persistence of government-to-government deals that still control routes. Mr Bisignani is furious at the breakdown of talks between America and the European Union, which were supposed to introduce free competition across the Atlantic. The key concession which America and the EU should make, he says, is to allow foreign airlines to own majority stakes in their own airlines. That would open the door to international mergers and allow consolidation to eliminate excess capacity from the airline industry. Such a process would also end the long nightmare of America's beleaguered airline industry. It is a dream that one day just might fly.

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The future of auditing

Called to account

Nov 18th 2004
From The Economist print edition

The auditing industry has yet to recover from the damage inflicted by an era of corporate scandals

NO ONE becomes an auditor because the job is adventurous. In recent years, however, the profession has been really rather racy. Auditors have been implicated in fraud after fraud. The Enron scandal brought down Arthur Andersen, which had been one of the profession's five giant firms. Now a scandal at Italy's Parmalat that was uncovered in late 2003 threatens Deloitte & Touche, another global giant, as well as Grant Thornton, an important second-tier firm. And new scandals are still emerging: most recently, financial manipulation was discovered at Fannie Mae, America's quasi-governmental mortgage lender, and at Nortel Networks, a telecoms-equipment group.

Investors depend on the integrity of the auditing profession. In its absence, capital markets would lack a vital base of trust. So it is no surprise that scandals have triggered changes in the profession. In America it has seen self-regulation dissolved in favour of the Public Company Accounting Oversight Board (PCAOB), in effect, a new regulator. It has been deluged with new rules, restrictions and requirements as part of the Sarbanes-Oxley act. In Europe the Eighth Company Law Directive, which, among other things, deals with the auditing profession, is progressing, albeit slowly, towards enactment. Britain's Office of Fair Trading is in the midst of scrutinising its audit industry.

One consequence of all this change is that audits have become tougher. The requirement introduced by Sarbanes-Oxley that auditors report to independent non-executive board directors rather than company management has reduced one overt conflict of interest. The certification of financial reports by chief executives and chief financial officers has focused minds. And the PCAOB has begun its inspections of audit quality and internal controls at auditing firms. Its first, mostly reassuring, reports were published in August.

Auditors themselves say they have toughened their standards and beefed up internal controls. And checks-and-balances in the financial system have been working better. Audit committees are taking their roles more seriously and asking tougher questions of management and auditors; activist shareholder groups, such as Calpers, are holding company auditors to standards that are higher even than those required by law, especially when it comes to their provision of non-audit services. Auditors even have more business, thanks to the new rules they must implement.

Yet despite this flurry of activity, behind the scenes there is a feeling among auditors that they are still a long way from meeting all the challenges they face. True, there are promising solutions to, say, the

problem of conflicts of interest. But leading auditors point to one central concern: what, if anything, can be done to reduce the industry's alarming concentration? That problem seems almost intractable.

The world's biggest companies rely for their annual audits on a tight oligopoly of just four accounting firms. According to the General Accounting Office, a congressional watchdog, the “Big Four”—Deloitte & Touche, PricewaterhouseCoopers (PWC), Ernst & Young (E&Y) and KPMG—audit 97% of all public companies in America with sales over $250m. They audit more than 80% of public companies in Japan, two-thirds of those in Canada, all of Britain's 100-biggest public companies and, according to *International Accounting Bulletin*, they hold over 70% of the European market by fee income.

This dominance raises two concerns. Is concentration stifling competition and lowering the quality of audits? More alarming, if one of these firms were to buckle, could the system cope with only a Big Three? “The dilemma is that these firms are too important to fail—but there are mechanisms by which they could fail,” says Paul Danos, dean of Dartmouth College's Tuck Business School. “These are shaky foundations for financial markets.”

The concentration of the audit industry is a relatively new phenomenon. Until the Great Depression, company audits were voluntary. But as part of the Securities Acts of 1933 and 1934, listed companies were required to disclose audited financial information to the public. The franchise was given to the private sector, and so the auditing industry was born.

For several decades, hundreds of auditors plied their services to public companies without much ado. A big change came in the industry in the 1970s, when rules restricting auditors from advertising and competitive bidding were loosened, unleashing fierce competition—often on price as much as audit quality. Around this time, audit firms began to move more heavily into consulting, starting their transformation into multi-disciplinary conglomerates peddling everything from legal and strategic advisory services to the installation of computer systems.

As listed companies grew bigger and more global, audit firms did too through a series of mergers and acquisitions. By the 1980s, eight firms dominated the American auditing industry. By 1998, this was down to five. After the SEC's criminal indictment of Andersen in 2002 for obstruction of justice in the Enron fiasco, the Big Five became the Big Four.

Big, bigger, biggest

There are arguments in favour of such scale, at least where the world's biggest companies are concerned. Unlike looser alliances of disparate accounting firms, which find it difficult to monitor audit quality across countries, the truly international audit firms spend piles of cash on common training, internal inspections and the like, spreading the substantial costs for these procedures across their relatively big capital bases.

Also in theory, although this is perhaps more arguable in practice, big firms can be tougher auditors because they are not overly dependent on the profits they derive from a single client. They can also develop the specialised expertise needed to audit increasingly complicated clients—Citigroup and HSBC, for example, have banking activities spanning derivatives trading to syndicated loans, spread across dozens of jurisdictions.

The question facing the industry is how few firms would be too few? In 2003, after the implosion of Andersen, the General Accounting Office addressed this question at the behest of a worried Congress. It found no evidence of collusion among the top firms. Nor was there evidence that the audit profession's concentration hurt the quality of big-company audits (although this is an inexact exercise).

The real concern is not so much that four firms are too few, but that four could fall to three. According to a report by Glass Lewis, a research consultancy specialising in corporate-governance issues, Andersen's collapse prompted approximately 1,300 firms to scramble to find new auditors. Today the Big Four already have their hands full dealing with the PCAOB's new rules. Cono Fusco, a partner with Grant Thornton in America,

says that a further collapse “could cause paralysis in financial markets”, especially if it were to occur near the end of the year when companies file their financial reports.

More importantly, a Big Three would almost certainly be too few to ensure an adequate degree of competition in large-company audits. As it is, some firms are already finding it tricky to comply with the PCAOB's new rules, which restrict the provision of certain non-audit services by auditors. This is particularly the case because of Section 404, a new rule that requires public companies to have their internal controls, as well as their financial reports, checked by an independent auditor.

Take Sun Microsystems, which has annual sales of $11 billion and operates in 100 countries. It uses KPMG, Deloitte and PWC for work on internal controls, valuation, tax and internal audit, while E&Y is its external auditor. Trying to juggle these relationships is a “time-consuming pain”, says Lynn Turner, a former SEC chief accountant who sits on Sun's audit committee. Yet Sun is too far-flung for it to be able to appoint a second-tier firm.

The counters counted

Top ten global accounting firms by fee income, 2003*

Firm	Fee income $bn	Growth, % increase on previous year	Total employees
Deloitte & Touche†	15.1	21	119,770
Pricewaterhouse-Coopers‡	14.7	7	122,820
Ernst & Young‡	13.1	30	102,968
KPMG§	12.2	13	98,900
BDO International§	2.7	11	23,226
RSM International††	2.1	14	20,436
Grant Thornton International‡	2.0	na	na
Moores Rowland International§	1.8	14	20,852
Horwath International§	1.6	1	18,454
Baker Tilly International‡	1.5	10	17,029

*Financial years ending †May or ‡Jun or ††Aug or §Sep
Source: International Accounting Bulletin/Lafferty

This problem is especially acute in certain industries. According to the *Public Accounting Report*, an industry newsletter, the market share of three of the Big Four firms (E&Y, KPMG and PWC) in the oil and gas industry was 97.3% by revenue audited. In the casino industry, just two firms (Deloitte and E&Y) audited 88.2% of the industry by the same measure in 2004. Similar concentration exists in the air transportation, coal and other industries.

Given this, regulators might feel constrained in how they respond to sloppy or unscrupulous behaviour on the part of the Big Four. Almost everyone agrees that Andersen's collapse made the financial system more vulnerable. So far, regulators have dealt with those improprieties that have come to light with narrow, targeted bans. For example, earlier this year E&Y was handed a six-month ban on taking on new, listed clients. It was found to have violated conflict-of-interest rules by forming a business partnership with PeopleSoft, a software firm that was also one of its audit clients. But who can say that another scandal on the same scale as Enron or Parmalat will not surface? “The reality is that the Big Four is very likely too big to fail. Regulators know this—and that is a huge moral hazard,” says Jim Cox of Duke University.

A naked option

The mountain of litigation facing the profession as a whole, and the Big Four in particular, injects real bite into these concerns. Neil Lerner of KPMG says there is an estimated $50 billion in claims outstanding against the Big Four. Settlements can be enormous (see chart). And the worry is that even the likelihood of a big payout could trigger a mass exodus of accounting partners, followed by clients, then by more partners. “Andersen didn't die because of the SEC's indictment per se,” says Mr Lerner, “but because its international network unravelled. It was a death spiral.”

The cost of litigation and size of claims have mounted steadily over decades, but in the post-Enron era both have “spiked like a hockey stick,” says Bill Parrett, boss of Deloitte in America. Some 10-20% of the Big Four's audit revenues are routinely funnelled into litigation costs (settlements, insurance and the like), which are then passed on to consumers. The Big Four have huge problems getting insurance, particularly against unpredictable “catastrophic” risks. “Ten years ago, there were 150 commercial insurers providing indemnity to the major auditors,” says Tom McGrath, a senior partner at E&Y: “Now there are ten.”

Never mind the quality

Top ten shareholder settlements by accounting firms

Auditor	Company	Audit firm settlement $m	Date
Ernst & Young	Cendant	335	Dec 1999
Andersen	Baptist Fund of Arizona	217	Mar 2002
KPMG	Rite Aid	125	Mar 2003
KPMG	Lernout & Hauspie	115	Oct 2004
Andersen	Sunbeam	110	May 2001
Andersen	Colonial Realty	90	Jul 1997
KPMG	Oxford Health Plans	75	Mar 2003
Andersen	Waste Management	75	Dec 1998
Pricewaterhouse-Coopers	MicroStrategy	55	May 2001
Ernst & Young	Informix	34	Jun 1999

Source: Public Accounting Report

In theory, such pressure is a disciplining force on the profession. The Big Four concede that they should pay something if they are to blame for their part in accounting fraud. But ultimately, they argue, fraud is perpetrated by company managers, not their auditors. Auditors claim they bear the brunt of any financial damages sought because they have deep pockets and are often “the last man standing”, says Sam DiPiazza, chief executive of PWC. In effect, auditors have become the insurers of financial statements, writing what Mr Fusco likens to a naked (ie, unhedged) option: “You get unlimited exposure for a limited reward,” he says. Critics see that as special pleading—after all, the whole point of auditing financial statements is to give some form of guarantee that they are credible.

But the unintended consequence of litigation run amok, argues the profession, is that audit quality is worse. Accounting rules are increasingly interpreted prescriptively rather than based on broad principles that are seen as too fuzzy to hold up in court. Auditors themselves, fearful of lawsuits, are inclined to adopt a “check-the-box” approach, adhering strictly to accounting rules rather than exercising (necessarily subjective) judgment. And the looming threat of litigation, argues the profession, hurts the recruitment and retention of the best and brightest talent. “Who wants to be a partner in a firm that faces billions of dollars in lawsuits?” asks one company boss.

The cap doesn't fit

Arguably the litigation problem worsens the issue of industry concentration, because only auditors with deep pockets can afford to take on the risk of making a mistake with a large public company. The Big Four point out that some European countries have caps on auditor liability. As a consequence, they say, there is significantly less concentration in these markets, an outcome they seem willing to contemplate. In Germany, for example, where auditor exposure is capped at €4m ($5.2m), 67 of the biggest 300 listed companies are audited by firms outside the ranks of the Big Four. In Greece, where the audit cap is set, bizarrely, at five times the salary of the president of the Supreme Court, 27 of the 60 companies listed on the Athens stock exchange are audited by firms outside the Big Four.

But these arguments have failed to sway regulators in America and Britain, where auditor-liability reform is most debated. Britain's Office of Fair Trading recently considered and rejected auditor caps, saying that it found little evidence that caps encouraged competition or would do anything to reduce the risk of the collapse of a Big Four firm. Indeed, caps might make concentration worse, since they would help the Big Four, who are already most exposed, more than smaller outfits. As for recruitment, figures show that, in America at least, the number of students taking accounting courses has risen sharply since the scandals at Enron and WorldCom were uncovered.

Can anything be done to shore up the audit profession's latent instability? Ideally, the market would self-correct. “Where profits are to be made, you should find new entrants,” says Peter Wallison of the American Enterprise Institute, a think-tank. But the barriers to entry in the audit of the biggest companies are exceedingly high. Building huge international networks is difficult and expensive. And legal rules in many countries mean that audit firms have to be partnerships, so cannot raise funds on the capital markets.

Regulation is another big barrier. The cost of doing public audits has increased dramatically, stretching capacity thin. As an indication of increased regulatory costs, E&Y's Mr McGrath says that so far this year, his firm has spent nearly 400,000 man-hours on training and education on Section 404 alone. “Given how expensive it is to comply with the new regulations in order to do audits of public companies, and the significant downside from litigation, why would a smaller firm want to take this on?” asks Mr Wallison.

Even the next tier of international firms—BDO Seidman, Grant Thornton and MRI—admit that they do not have the capacity to audit the world's biggest companies. Nor do they feel much inclination to do so. These firms are already thriving by auditing middle-sized firms, which, they are quick to point out, encompass many *Fortune* 500 companies. BDO, for instance, currently audits sub-*Fortune* 100 international companies such as Barnes & Noble, a bookstore chain. Grant Thornton in America says its cut-off is around the level of the companies towards the bottom of the *Fortune* 250 list.

Second-tier accounting firms have made some progress. According to the *International Accounting Bulletin*, the eight largest mid-tier firms gained 122 clients from the Big Four in the first seven months of this year; only nine companies went the other way. But that barely affects concentration. Mergers among the second-tier accountants could speed things up, but a recent General Accounting Office study found that even a merger of the next four or five biggest firms would not create a fifth big firm that could compete well with the Big Four.

Without a viable market solution, some wonder if more drastic action might be needed. Mr Danos of the Tuck business school, believes that the Big Four should be forced in some way to become six or eight firms, by government mandate if necessary. His fear, shared by many, is that should another Big Four firm collapse, there is a real risk that the government would take over audits and that financial markets would suffer long-term harm. Indeed, some say a continuation of the current state of affairs is leading towards a creeping nationalisation of the industry. “We have become a highly regulated industry and this will only continue,” complains one audit-firm boss.

Rotate and restrict

Rather than a radical move such as a break-up, some suggest that smaller reforms could help second-tier firms grow into bigger ones over time. Mr Cox of Duke University suggests two possibilities: mandatory rotation of entire audits rather than the more limited rotation just of individual partners as is now required in America; and sharp limits on the provision of non-audit services. “These types of changes will lead to a change in competitive structure,” he predicts, encouraging smaller firms to develop pockets of expertise where they can compete with the Big Four.

Others believe that caps or other restrictions on allowable market shares for the Big Four in certain segments (especially middle-market companies) would help the second-tier accounting firms to grow. But many second-tier firms find the idea of restricting clients' choice unpalatable, particularly since these restrictions would yield a viable fifth big competitor only over many years, if at all. Auditors have been good (perhaps too good) at helping their clients solve tricky problems. So far, at least, their own industry's concentration looks like a challenge too far.

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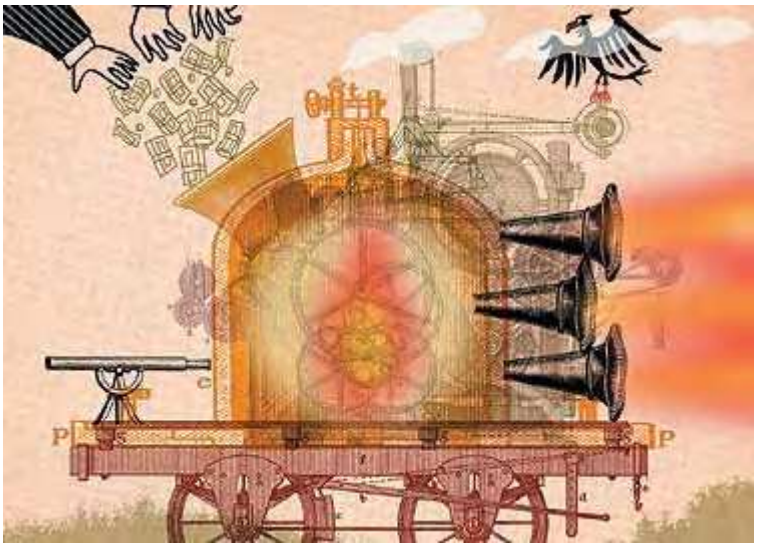
Refinancing corporate Germany

New fuel for an old engine

Nov 18th 2004 | FRANKFURT
From The Economist print edition

Foreign investors are vital to German companies' financial revolution. But the locals are stirring too



BIT by bit, it is becoming less easy to caricature corporate Germany as being stuck in the past. Competitive reality is unsettling the old, cosy relationship between bosses and workers (see article). Corporate governance is becoming a little more transparent. Less obviously, the way German companies are financed—for most of them, a mixture of private, often family ownership and loans from the bank—is changing too.

However, it sometimes seems that foreign private-equity firms are the sole agents of this financial change. Only this week, one such firm, Terra Firma, emerged as the buyer of Tank & Rast, an operator of motorway service stations that is already mostly owned by other private-equity funds. Another private-equity outfit, Lone Star, was set to buy Mitteleuropäische Handelsbank, a subsidiary of NordLB, a public-sector bank. The foreigners' prominence reflects the slowness of German banks, companies and capital markets to re-engineer corporate Germany by themselves.

Studies suggest that companies that open themselves to new sources of finance, whether private equity or new types of debt, benefit from it. One study—co-sponsored, admittedly, by a German private-equity firm—found that a sample of 45 companies that had taken on private equity between 1993 and 1999 grew faster and created more jobs between 1999 and 2003 than those that had not. An annual survey of *Mittelstand* (essentially, small and medium-sized) companies by Kreditanstalt für Wiederaufbau, the state development bank, finds that those that took on new debt or equity saw their workforces increase: those that did not, shed employees. Another study, by McKinsey, attributes the relative success of private-equity investors to what it calls “active ownership” and more effective corporate governance.

Granted, the rigour of all these surveys can be questioned. One problem is that private-equity firms and other investors tend to select the firms they think likely to do best. And most of the *Mittelstand*—a loose term, covering perhaps 3.4m companies employing 26m people—comprises companies too small to benefit from fancy financial tricks. Still, the promise of growth and jobs may embolden some firms to overcome their traditional suspicion of outside capital.

In fact, below the headlines, corporate finance in Germany is going through enormous upheaval,

comparable to that in America after the savings-and-loan crisis of the late 1980s. Nearly every bank is restructuring its loan portfolio and trying to sell its unwanted and non-performing loans. Here again, American funds and investment banks have stepped in, as they have in Japan: Lone Star recently paid an undisclosed sum to Hypo Real Estate, a subsidiary spun out of HVB, Germany's second-biggest bank, for €3.6 billion ($4.7 billion) of non-performing loans. Many packages of discounted property loans have been sold in synthetic or securitised form. The potential benefit, for companies, is that the banks recover some capacity to lend new money.

The range of banks' lending rates has widened dramatically, partly because of new risk-based capital charges, which will apply when Basel 2 regulations come into effect from January 2007, and partly because banks are in any case pricing risks more cannily. Lending margins have been trimmed for the safest borrowers, while companies regarded as high or medium risk are being asked to pay far more.

Debt not dilution

Faced with having to pay more for bank loans, the traditional source of outside finance, what is a capital-hungry company to do? Firms that are reluctant to sell equity are beginning to opt for mezzanine or subordinated debt. Suppliers of such capital charge a higher margin than senior lenders, but the owners' equity is not diluted. Since the loan is subordinate to senior debt it also has less effect on the borrower's credit rating. These days, because of Basel 2, the level at which a company is rated internally by banks has a vital bearing on its everyday access to funds.

Mezzanine finance is likely to grow rapidly in Germany. Several banks are offering it. M Cap Finance, the first independent mezzanine fund in Germany, started in April this year and estimates that continental Europe will see €4 billion-5 billion of such debt in 2005. Many private-equity deals also include a slice of mezzanine finance as working capital.

Triumph-Adler, a *Mittelstand* company, managed to raise new capital in September by means of mezzanine finance alone, while improving its standing with the banks. The result of a merger in 1956 between two motorcycle makers, the company progressed from making bikes and typewriters to image-processing and information technology. Its ownership has changed several times; its biggest shareholder now, with 25%, is Kyocera Mita, a Japanese maker of photocopiers and printers. With no generous parent to refinance it, Triumph-Adler turned, quite typically, to its house bank, Deutsche Bank, Germany's biggest lender.

The answer was not, as it might have been in the past, more money from Deutsche Bank, but the replacement of loans from 50 different banks with an 11-bank syndicated loan. It also won mezzanine finance from Dresdner Anschutz Mezzinvest, of which Dresdner Bank, another big German bank, owns half.

Such financial re-engineering looks likely to be the shape of things to come for many *Mittelstand* companies. It may be more costly than traditional bank loans, but it leaves the firm more robust, at least in the eyes of its bankers. This makes it easier, for example, to fund the leasing of products to its customers.

Deals like this will become more common as the banks put their own house in order. That is happening, but slowly. One example is “True Sale International”, dreamed up by 13 banks, which offers banks and companies a platform for securitising their assets. It was announced with fanfare nearly two years ago, but the first deal was done only this week. Even then, the bonds, backed by Volkswagen car loans, had to be listed offshore because of German prospectus law. Companies still cannot securitise assets directly, because it seems they still may be liable for sales tax each time the security is sold. For this reason, Volkswagen's bank subsidiary, not the carmaking parent, issued the bonds.

There are other initiatives to stimulate a secondary loan market. In Munich, Deutsche Kreditbörse, owned by a consortium of banks, has teamed up with Standard & Poor's, a rating agency, to standardise ratings and valuation of bank loans in preparation for resale. The Hamburg stock exchange is considering adding a bank-loan segment to its other traded markets. And DebtX, which runs a secondary loan market in Boston, has teamed up with Günther & Partner, an advisory firm in Munich, to get the ball rolling in Europe.

This is all promising: German financial institutions and their clients are becoming more inventive almost by the day. But there is a lot of catching up to do. Meanwhile, though, the foreign private-equity funds

will continue to rule the roost.

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Japan's economy

Heading south again?

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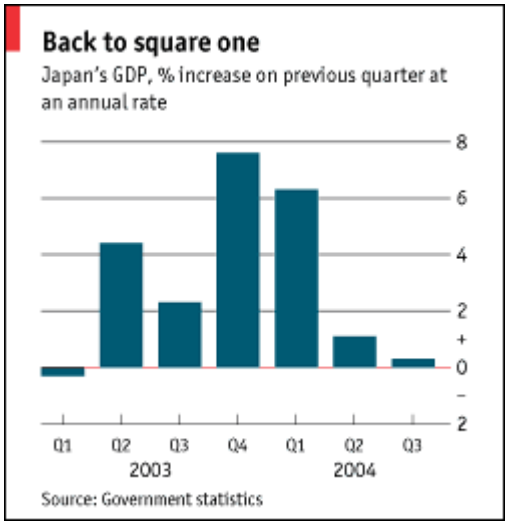
The economic slowdown in Japan is not as severe as it seems



HAS Japan's economy stalled again? Real GDP growth fell to an annualised rate of only 0.3% in the third quarter, from an already sluggish 1.1% in the second quarter. The pace has slackened alarmingly since last winter, as costlier oil and a slowing of China's imports have hit Japan harder than expected.

Yet things are not as bad as they look. Japan's quarterly GDP figures are notoriously volatile and subject to big revisions. Quarterly growth in late 2003 and early 2004 (7% at an annual rate) was almost certainly overstated. Year-on-year figures are more reliable and these show real GDP still growing by 3.9% in the year to the third quarter—exactly the same as in America.

Another problem with Japan's GDP numbers is the deflator used to convert nominal into real growth. This is widely believed to have overstated the decline in prices—and thus the increase in real GDP. For example, in the year to the third quarter, nominal GDP rose by only 1.7%, but the real rate was 3.9%, because the GDP deflator fell by 2.1%. By contrast, the consumer-price index was flat in the year to September.

All of the slowdown in real GDP growth in the third quarter was due to an easing in the rate of deflation, to an annualised 0.3% from 2.6% in the second quarter. Nominal growth quickened.

Focusing on the real GDP numbers, the main causes of the latest slowdown were falls in corporate investment and export growth. Indeed, trade (ie, exports minus imports) had a negative impact on growth for the first time in two years. The good news was that consumer spending continued to grow, at an annual pace of 3.7% in the third quarter.

Japan's government has downgraded its view on the economy for the first time in 17 months. The latest numbers will therefore serve a useful purpose if they deter a premature increase in taxes to reduce the government's deficit. That could really trip up the recovery.

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Standard Chartered

Uncharted territory

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A British bank's plans—and problems—in China

Reuters

Davies has his eye on China

MERVYN DAVIES, the chief executive of Standard Chartered, is fond of pointing out that his bank has been in China for 150 years and is "obsessed by it". As yet, alas, the British-based bank has little to show for its fervour or its patience. One of the main goals of its "China strategy", namely to buy a significant stake in a mainland lender, has so far eluded it. And further signs of the bank's difficulties apparently came on November 15th, when Peter Wong, its chief executive for Hong Kong and China for the past four years, resigned. Most assumed that he left because he disagreed with a board decision to cut costs and staff in Hong Kong. It might, instead, signal that a deal is afoot. "I am very comfortable that there will be a deal—or two—in the next weeks or months," says Mr Davies.

That it hasn't happened yet, despite Mr Wong's extensive connections, has been all the more galling because competitors have been snapping up stakes in Chinese banks. HSBC beat its smaller rival to take a 20% stake in Bank of Communications, China's fifth-largest lender, for $1.7 billion in August, and has 8% of Bank of Shanghai. HSBC's subsidiary, Hang Seng Bank, has taken a holding in Industrial Bank. Citigroup has a stake in Shanghai Pudong Development Bank. And even a private-equity firm, Newbridge Capital, has won a controlling share of yet another lender, Shenzhen Development Bank.

Bryan Sanderson, Standard Chartered's chairman, betrayed the board's frustration earlier this month, when he proclaimed that the bank was just "weeks away" from buying 20% (the maximum allowed) of a big Chinese lender. That left Mr Davies the unenviable task of having to row back on the timing of any deal.

The group has tried to make the best of a poor hand by stressing the virtues of organic growth. But growing organically takes an age: the authorities allow foreign banks to open just one new branch a year (though in a fit of liberalisation, the government will soon allow them to open two). Despite being the second-biggest foreign bank in China after HSBC, Standard Chartered has just eight branches and five representative offices on the mainland. Small wonder that Mr Davies is so keen for a deal with a Chinese bank.

Whether it will be the right one is yet to be seen. With most of the world's top lenders falling over one another to gain a foothold in the world's fastest-growing large economy, a middle-sized bank such as Standard Chartered, with shallow pockets, always risks losing out on the largest and most attractive deals.

That has certainly been the case elsewhere in Asia. Earlier this year it lost out to Citigroup in its attempt to buy KorAm, a big South Korean bank, as a way into Asia's biggest consumer-finance market, when Mr Davies refused to match the price offered by the Americans. In Indonesia, it was trumped by a group backed by a big domestic cigarette company in its bid for Bank Central Asia; it managed to secure a controlling stake in the much smaller Bank Permata only last month.

But it is China that the bank is keenest on. The best option would probably be to emulate HSBC and attempt to gain a chunky, influential holding in one of China's 11 joint-stock banks (which are small, are

not 100% state-owned and have licences to operate nationwide). In the past it has flirted with China Everbright, the country's sixth-largest bank, which analysts say has decent risk management (by Chinese standards, at least) and is already branching out into private banking.

Standard Chartered is also considering other joint-stock targets, such as China Merchants and Minsheng, although the latter is not well regarded. While nothing is ruled out, with foreigners allowed to invest in just two Chinese banks, a well-placed insider in China says Standard Chartered is unlikely to buy part of China Construction Bank or Bank of China, the two big state banks being groomed for flotation. Ensuring that your stake buys you influence is vital, and even a 5% share of these banks would cost a lot for no control.

The bank's profits have grown quickly in the past three years, and its shares are riding high. But to keep both rising Standard Chartered needs to do something bold but not rash, particularly in China. Mr Davies insists that it is “not a macho race”, but he is clearly under pressure. It would be an irony were Mr Wong to be snapped up by Bank of China or another mainland lender while his former employer was still struggling to find a partner.

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Real-estate investment trusts

Now Hong Kong catches on

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Easier property investment reaches Hong Kong—and, slowly, even Britain

FOR Americans, REITs—real-estate investment trusts—are old hat. They have been around since the 1960s, though they have only really taken off in the past 15 years, growing from less than $10 billion of assets in 1990 to more than $400 billion today. Australia opened its doors to REITs in 1971, Japan in 2000, South Korea and Singapore soon thereafter, and now, after an early fumble, Malaysia. France legislated for its version in 2002, Britain (its government says) will do so soon, and Italy and Germany may follow later. Mexico's bourse authorities have plans. But next month these laggards will find themselves all overtaken by Hong Kong.

REITS have a double merit. They offer even small investors a lowish-risk and liquid way into property; and, so long as they distribute nearly all their profits—90% in America and Japan—as dividends, they usually escape corporation tax and capital gains tax. The REIT about to be launched, three months sooner than was expected, by Hong Kong's housing authority is to be called Link. It will be a whopper: 1.75m square metres of shops and car parks, some of it run-down but still worth, in all, up to $4.5 billion, about 30% of the market value of all Japan's REITs put together.

This is bigger than earlier estimates of Link's size. But it looks practicable. The assets, spun off by the housing authority, will be transferred to and managed by CapitaLand, a property arm of the Singapore government's giant Temasek group. CapitaLand already has assets in Hong Kong, and has done well in raising returns from the two REITs and other property that it owns in Singapore and elsewhere. Link may well put 100% of its profits into dividends; the result, says one adviser, could be a dividend yield near 7% next year, against the 3% of typical property stocks in Hong Kong.

Who will invest? Hong Kong's property market is unusually liquid, and the territory levies no tax on dividend income; so a REIT there has fewer charms than elsewhere. But it still cuts risk in a market that has recovered from the SARS epidemic but could be hard hit if interest rates rise. And Hong Kong's securities watchdog has just agreed to let its fund managers, until now barred from real-estate investment, put as much as 10% of their net assets into REITS.

Britain's finance minister, Gordon Brown, announced plans for a REIT structure in his March budget, but did not explain the details of his proposal. Property companies are now impatiently awaiting the result of his wide consultation. On the right terms, some would happily convert into the new “property investment funds” (PIFs), as Mr Brown has chosen to call Britain's version of REITs. With only a handful of mutual funds now in property under current rules, investors too might welcome the new vehicles: aided modestly by rising rents, but far more by rising expectations, British commercial-property values and share prices have soared this year.

But if property companies turn themselves into REITs, will they have to pay a once-off tax (France charges half the potential capital-gains tax due)? What gearing will Britain's new PIFs be allowed? What share of profits will they have to distribute? Will they really escape all the usual corporate taxes? Will they have to invest partly in housing? Or be barred from certain sectors, such as hotels? The industry is alive with warnings that, if the rules are too tight, the new PIFs may flop, like the “housing investment trusts” proposed by a Conservative government in 1996.

The answers may come in Mr Brown's pre-budget report on December 2nd. But they may not be pleasing. He is not in the habit of giving tax-breaks to property developers, nor to giant office developments: though the industry prefers to forget it, his plans were explicitly linked to a need for more, and more “affordable”, rented housing. In Britain today, that is not a market that wise investors will rush into: after a boom, house prices are on the slide.

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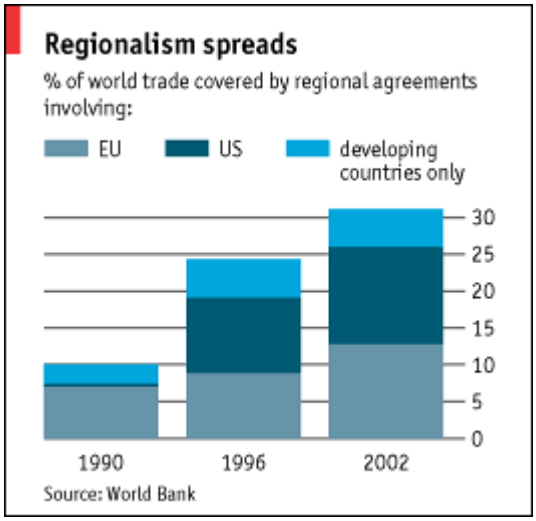
Trade policy

Exclusive

Nov 18th 2004
From The Economist print edition

Not all trade agreements are good



FRIENDLY country? Want a trade deal with America? Join the lengthening queue. On November 15th, the Bush administration announced that it intended to negotiate trade agreements with Oman and the United Arab Emirates. The United States is, therefore, now working on bilateral trade accords with 12 countries. It has already finished such deals with another dozen.

Foreign policy, more than economics, drives some of these deals. The Oman and UAE agreements, for instance, are deemed to be “important steps” towards boosting growth and democracy in the Middle East. But Mr Bush's trade team also believes that freer global trade is best served by “competitive liberalisation”: pushing trade deals at the bilateral, regional and global level simultaneously.

America is merely the latest fan of a broader global trend. As a new World Bank report, “Global Economic Prospects 2005”, points out, regional and bilateral trade deals are all the rage. Almost 230 such agreements exist today, up from a mere 50 in 1990, and a further 60 or so are being negotiated. The average African country belongs to four different trade agreements. The average Latin American country belongs to eight.

Alas, the passion for such agreements may be misguided. Economists have long pointed out that the gains from multilateral trade liberalisation are far greater than those from bilateral or regional deals. At best, regional deals offer smaller benefits. At worst, they do damage, artificially diverting trade away from excluded countries or clogging up commerce with fiendishly complicated “rules of origin”. These are needed to define whether imported goods, which may consist of inputs from many different countries, qualify for favoured treatment.

Though the Bank's report tries to emphasise that regional trade agreements can boost trade, the record is not encouraging. Two-thirds of the tariff reduction seen globally between 1983 and 2003 was due to unilateral reforms by individual countries. A quarter came from commitments made in the Uruguay Round of global trade talks. Only a tenth of global tariff cutting is due to regional and bilateral deals.

Most bilateral agreements are far from ideal. Those between poor countries often exist more on paper than in practice. Bilateral deals between rich and poor tend to be better implemented, but are marred by restrictive rules of origin and by the routine exclusion of important agricultural products.

In fact, the Bank's boffins point out that most poor countries would be worse off in a world of rampant bilateral deals than they are today. A simulation in the study estimates that a broad global trade agreement could increase world income by $263 billion by 2015, of which $109 billion would go to poor countries. If developing countries all had bilateral agreements with big rich trading partners (the European Union, the United States, Canada and Japan), global income would rise by much less: $112 billion. The rich would scoop all this, and more: $133 billion. Although a handful of developing countries, such as Brazil and China, would gain a bit, poor nations as a group would be worse off than they are today.

While the Bank's exact numbers should be taken with a pinch of salt, the broad lesson is clear. Bilateralism may be a route to freer global trade, but it is, at best, a risky one.

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Microfinance

Small sums, big issue

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The United Nations turns its attention to finance for the poor

AMONG the more benign activities of the United Nations is the dedication of various years to specific causes. Mountains, deserts, rice and dialogue have all had their 365 days of fame. There is little evidence that the attention has done mountains, deserts, rice and dialogue any harm—but also not much to suggest that they have benefited either.

In the next 12 months the spotlight falls on microfinance, the business of lending small amounts of money to the poor, taking deposits from them, transmitting money on their behalf and insuring them. With luck, the UN's effort will turn out to be substantial rather than symbolic. It certainly kicked off in style, with a big party at the UN's New York headquarters that demonstrated how fashionable the subject has become. Among the 700 in attendance were top bankers, politicians and a film star or two. The UN also announced the appointment of an advisory panel to consider what may be impeding the growth and effectiveness of microfinance. Its members include businessmen and financiers (as well as the editor of *The Economist*'s business section).

The success of the year depends to a great extent on whether the UN can harness its member states and financial institutions to establish some basic facts. Remarkably little is known about how finance operates outside wealthy countries. No good data exist on how many people have access to financial institutions, the breadth and penetration of banks in poor countries, the real cost of a loan and the time it takes to get one, the ease of making a deposit and so forth.

Microfinance itself is something of a mystery. There are no authoritative figures on the number and performance of microlending institutions. There is not even convincing information, beyond lots of anecdotes illustrated by photographs of women in rural villages, about whether microfinance makes any significant contribution to economic growth or is merely another philanthropic fad.

In principle, loans to the poor should bring great benefits. Because the poor have less capital and often can borrow only with great difficulty, if at all, they ought to use extra capital more productively than the rich. Indeed, this might explain why even in the poorest places there is some form of money lending despite staggeringly high interest rates: 1,000% a year is not uncommon. However, such rates inevitably take a toll on enterprise and economic growth. The year of microcredit will have proven to be of great worth if it can first document the impediments to more efficient forms of financial intermediation and then begin to clear them away.

For example, the UN would do well to address the common complaint that banks ignore the poor out of class bias. If they do, the UN's interest may hasten change: some financial institutions are already making efforts to work with the poor, either directly or by providing wholesale services to smaller financial institutions. And many working in microfinance complain that their small size and lack of traditional assets make it hard to attract capital either on their own account or through syndicated loans. A year hence, perhaps some of this will have changed.

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The New York Stock Exchange

Beyond equities?

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Change is afoot at the NYSE

AP

Here comes the hybrid!

JOHN THAIN, chief executive of the New York Stock Exchange (NYSE), speaks admiringly of the sleek organisation of his transatlantic counterparts. Big European bourses, he notes, may be consolidated geographically; offer a vast array of products; and do their own clearing and settlement as well as trading.

Despite being the world's largest equity exchange, the NYSE looks flat-footed by comparison. It is stuck in one country (indeed, one city); specialises in equities, to the exclusion of other products such as derivatives; and cannot clear or settle. The exchange also relies on floor traders for handling 90% of share volume. Many other exchanges—in America as well as Europe—have long since gone electronic.

All this could change. Modernisation is first on the order of business. Trades on the floor of the NYSE currently average 14 seconds, an absurdity in the automated age. So over the next year the NYSE plans to expand its electronic-trading capabilities to be able to process larger orders (the Securities and Exchange Commission will presumably go along with the plan). The end result is supposed to be a hybrid market that seamlessly meshes floor trading and electronic trading, as happens at the Chicago Mercantile Exchange, America's largest futures exchange.

Mr Thain dares not guess what proportion of trades will migrate to the electronic system, though the highly liquid stocks of big companies seem sure to switch over. Even those, however, may revert to the floor during crises—times like last month, when Merck withdrew its hot Vioxx drug and sellers vastly outnumbered buyers.

Even if the hybrid system rolls out smoothly, the Big Board faces daunting strategic questions. Like rival equities exchanges in America (not to mention London), the NYSE is struggling. Low volume and volatility have put off broker-dealers. The seat price (ie, the price of membership) has fallen by almost two-thirds in the past five years, despite ticking up a notch last week. Mr Thain readily admits that it is “hard to make money on the floor”.

How can that be changed? Offering new products is an obvious way to go. Already the NYSE is trying to elbow more into exchange-traded funds (ETFs), perhaps at the expense of its neighbour, the American Stock Exchange (Amex), where these popular, index-based securities got their start. The Amex has more than 120 ETFs listed, versus 17 for the NYSE. Last month an ETF based on China's Xinhua 25 index

began trading on the NYSE. The SEC is expected to approve a new gold ETF. This is eagerly anticipated by investors, and the Amex plans one too. The Big Board is also looking at prospects in fixed income (eg, convertible bonds) and derivatives, perhaps based on listed companies.

When—if—the matter of growth strategies is sorted out, governance questions will loom. One question is whether the NYSE, a non-profit organisation, should go public. Meanwhile, Eliot Spitzer, New York's attorney general, is suing the NYSE's former head, Dick Grasso, over Mr Grasso's giant pay package. Spurred by the Grasso imbroglio, the SEC last week voted to propose requiring that exchange executives' compensation be disclosed, and that most board members be independent (the NYSE has already made this move).

In fact, the SEC has been paying a lot of attention to exchanges lately. Last week Amex confirmed that three of its top officials received notices related to an investigation of the exchange's handling of options orders. The SEC is also reported to be scrutinising a number of broking firms which may not have got investors the best price during early-morning trading on NASDAQ. The NYSE is not the only exchange with half an eye on America's financial regulators.

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Economics focus

Guessing games

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Economists and policymakers are just beginning to understand the use of information markets

TALK is cheap, but money speaks the truth. That might be the credo behind the recent, rapid rise in the use of novel markets to forecast everything from political events to business successes and failures. During America's recent presidential election, bets on the Iowa Electronic Market, based at the University of Iowa, and on online exchanges such as www.tradesports.com and www.betfair.com were watched almost as keenly as opinion polls. These and other markets have in recent years been used to forecast almost everything from the fate of Saddam Hussein to the outcome of celebrity trials and the box-office takings of films on their opening weekends.

Markets like these, which are intended to elicit punters' best collective guess about the outcome of some future event, are known as information, prediction or decision markets. Take the presidential election: people could bet on George Bush by buying a contract that paid a dollar if he won and nothing if he lost. Anyone certain of a Bush victory should have been willing to pay up to a dollar for the contract. Anyone confident that Mr Bush would lose could have sold such a contract, expecting to pay nothing when the result came. With many participants buying and selling in this way, the market discovered a price for the contract—in effect, its best guess of the probability of a Bush win.

The theory is that the aggregated hunches of many people with money at stake are likely to be more accurate than the opinion of disinterested experts or of whoever happens to be at home when a pollster calls. Indeed, it is easier to put your money where your mouth is in information markets than in many “proper” markets. Because you can “sell” without first “buying”, short-selling, which is limited in many financial markets, is essentially unconstrained. And because the bets are smaller than in financial markets, participants are unlikely to be prevented from backing their opinions by restrictions on borrowing.

Most anecdotal evidence seems to bear this theory out. A recent paper* surveying the academic literature, by Justin Wolfers and Eric Zitzewitz, both of Stanford University's Graduate School of Business, reaches a similar conclusion. For instance, one study found that the Iowa Electronic Market, which started life in the late 1980s, predicted the vote shares of candidates in several elections between 1988 and 2001 with an average margin of error of 1.5 percentage points, compared with the polls' average error of 2.1 percentage points. This year the Iowa market and other exchanges predicted a narrow win for Mr Bush.

Businesses have also made good use of information markets. Siemens, a German conglomerate, used an internal market to forecast (correctly) that the firm would fail to deliver a software project on time, even though internal planning methods purportedly showed that the deadline could be met. At Hewlett-Packard, a market did a better job than traditional methods in forecasting printer sales. A joint-venture by Goldman Sachs and Deutsche Bank that uses markets to predict economic indicators has been at least as accurate as economists' median forecasts.

This is reassuring, but information markets are also prone to imperfections. One is that they can exaggerate traders' misperceptions of risks. Punters tend to put too much weight on the most likely events and on very unlikely ones, and too little on those of intermediate probability. According to the authors, one contract recently traded on Tradesports' exchange showed that gamblers were assigning much more optimistic odds to extreme stockmarket outcomes than were traders on Chicago's derivatives exchanges, where liquidity is much higher.

Participants in information markets also get swept away by their personal tastes: in much the same way

that some people bet on their favourite team regardless of the odds, people are likelier to back the political party they belong to. This should matter less in more liquid markets, because cooler participants will spot that partisanship has pushed prices out of line with probabilities, buy or sell to take advantage, and shift prices back. But smaller, illiquid markets might not be corrected in this way.

Better informed policies

There have been some efforts to use prediction markets to improve public policy. Last year, an American government body, the Defence Advanced Research Projects Agency, tried to create an exchange to trade contracts on the likelihood of a terrorist attack. (The Economist Intelligence Unit, a sister company of *The Economist*, provided data for this venture.) After protest—someone pointed out, among other things, that terrorists might profit from insider trading before striking—the project was shelved. Cheekily, one betting exchange created a contract on whether the project's boss, John Poindexter, would still be in his job on a certain date. It predicted, accurately, that he would not be.

Despite this debacle, Robert Hahn, director of the American Enterprise Institute-Brookings Joint Centre for Regulatory Studies, argues in a new paper† that information markets could be of great help in forming policy, especially when combined with performance-related contracts. Suppose that a foundation is thinking of paying $5 for every child vaccinated against a certain disease. Information markets can be used to estimate the number of children who will suffer from the disease both with and without the bounty. That gives a market-based estimate of the benefit to be had from paying the bounty. The foundation might then auction the rights to the bounty to ensure that the vaccinations are performed at the lowest cost. That sounds far-fetched now, but such schemes may one day be common, given the ability of well-designed, liquid markets to reveal information.

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* "Prediction Markets". *Journal of Economic Perspectives*, Spring 2004

† "Using Information Markets to Improve Policy". AEI-Brookings Joint Centre working paper 04-18

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Treating malaria

A feverish response

Nov 18th 2004 | BEIJING AND GUILIN
From The Economist print edition

A Chinese herbal medicine is effective against malaria. But there is not enough of it to go round

Get article background

TAKE a walk through the countryside around Guilin, a bustling town in the Guangxi region of southern China, and your eyes are immediately drawn up towering limestone peaks and down fast-flowing rivers. But one of the most remarkable things in this dramatic landscape is one of the easiest to overlook—a common plant which the Chinese call *qinghao*, and which western botanists have dubbed *Artemisia annua*. *Artemisia* holds the key to beating malaria, a disease that strikes at least 300m people a year, and kills around a million, mainly young children, throughout sub-Saharan Africa and south Asia. But *Artemisia* is also at the centre of a storm in international public health, as rising prices and short supplies threaten global efforts to loosen malaria's grasp on the developing world.

Artemisia has been used in Chinese medicine for more than a thousand years, to treat everything from malaria to skin complaints. In the 1960s, Chinese military scientists started screening hundreds of traditional herbs, including *Artemisia*, in an effort to protect their soldiers from malaria. One of the researchers, Tu Youyou, now director of the Qinghaosu Research and Development Centre at the China Academy of Traditional Chinese Medicine, managed to extract and characterise a chemical called artemisinin that gives the plant's leaves their anti-malarial punch.

Since then, scientists have developed chemical processes to convert artemisinin into more potent derivatives. These are good at killing malarial parasites in the blood, but their activity wanes after a few hours. So they are best given alongside another anti-malarial medicine, such as lumefantrine, which attacks the parasites in a different way and over a longer period of time—an approach called artemisinin-class combination therapy (ACT). This double whammy has proved extraordinarily effective at treating malaria. Trials in several African countries, as well as in India, Vietnam, Indonesia and Peru, have shown that at least 90% of malaria patients treated with ACT over three days recover from the disease.

ACT has become even more important now that other anti-malarial drugs, such as chloroquine, are losing their effectiveness because malarial parasites have evolved resistance to them. So far, resistance is not a problem with ACT, in part because combining drugs makes it much less likely that mutations in the parasite will enable it to survive. Since 2001, the World Health Organisation (WHO) has recommended that countries where drug resistance occurs switch to ACT. But international efforts to make the switch were sluggish until earlier this year, when a stinging paper published in the *Lancet* accused the WHO and the Global Fund to Fight AIDS, Tuberculosis and Malaria of “medical malpractice” for continuing to

approve and fund proposals from poor countries to treat malaria using older, cheaper drugs instead of ACT.

While denying the charge, both agencies have now sprung into action. Getting countries to switch to ACT is not only a question of securing the drugs, but also of training doctors in how to use them, and setting up surveillance systems to monitor resistance. The WHO estimates that the world will need 132m courses of ACT treatment (which cost up to $2.40 each) in 2005—a four-fold increase over this year—and almost double that number in 2006. So far, the Global Fund has set aside $205m to help finance the shift, with the promise of more to come.

The biggest problem, at the moment, is getting enough artemisinin. *Artemisia* grows like a weed across China and South-East Asia, but the best plants are found only in certain parts of China, such as Guangxi and Hunan, which produce most of the world's supply, and in Vietnam. The supply chain starts with local farmers, who harvest the leaves in August, when they are richest in artemisinin, and sell then to a handful of companies, mainly Chinese, which extract the chemical and change it into one of the more active derivatives. The chemicals are then sold to the likes of Novartis, a Swiss drug giant, which produce the combination therapies.

Just meeting this year's demand is proving tricky. The problem, says Yan Xiaohua, the president of Guilin Pharmaceuticals, one of China's leading producers of artemisinin and its derivatives, is not that there are too few plants, but that the price of leaves has shot through the roof. The reason is simple, he says. Once the WHO made its forecast of future demand public in the spring, the news filtered through to farmers, who quickly tripled the price of leaves, thus jacking up the price of artemisinin and its derivatives as well. This has caused particular headaches for Novartis, whose Chinese supplier, Kunming Pharmaceuticals, failed to deliver the promised quantities. That means that Novartis will only be able to fill half its promise of 10m courses of treatment by the end of the year.

The good news is that Mr Yan and others are optimistic that *Artemisia* prices will stabilise next year. But producers are far from certain whether they can rise to the WHO's ambitious expectations for the next two years. This week, UNICEF, the United Nations' children's fund, and the WHO called an emergency meeting in Copenhagen to discuss how to boost production and to keep prices under control.

One way would be to increase the production of *Artemisia*. In China, firms such as Guilin Pharmaceuticals are trying to cultivate the plant—both on their own plantations and through contracts with local farmers—rather than relying on wild leaves. Chongqing Holley, a sister company of Kunming's, has set up a research laboratory in Hunan to help it identify high-yielding plants and establish a seed bank. As Mr Yan points out, farming *Artemisia* not only gives firms more control over their supply, but also helps reduce the loss of biodiversity that comes from picking wild plants. The WHO is also keen to see *Artemisia* farmed elsewhere in the world. There are pilot projects to do this in Tanzania, Kenya and Mozambique, but it will take time before the quantity and quality of their production can make a real dent in the supply problem.

As Jeffrey Li, the head of Novartis's Chinese operation, points out, there is also a shortage of facilities that can produce high quality artemisinin and its derivatives. Novartis has been working with Kunming Pharmaceuticals and Holley Pharmaceuticals to upgrade their production capacity. But the great hope is to find a way of synthesising artemisinin in the laboratory, thereby freeing drugmakers from the vagaries of nature. Jonathan Vennerstrom, a researcher at the University of Nebraska, has come up with a five-step chemical process to make compounds that can mimic the action of artemisinin derivatives. One of them, called OZ-277, has proved more effective than artemisinin itself in both the test-tube and in animal models of malaria. It was also shown to be safe in recent trials in human volunteers, and a full clinical trial in Thailand is planned soon. If this trial is successful, then further testing is planned to see how well the new molecule performs in combination therapy. If OZ-277 lives up to expectations, then such a therapy might be ready for market by 2008, at less than $1 a course.

In the meantime, the world will have to meet its growing demand for artemisinin the old-fashioned way, from nature. The trouble, according to Fatoumata Nafo-Traoré, the director of the Roll Back Malaria department at the WHO, is that without more money up front, companies in the business of supplying artemisinin are reluctant to make the $25m-30m investment that it would take to start planting on a large scale. Although the Global Fund has earmarked money for this purpose, the way it is disbursed means that the process is too slow and too fragmented to give firms that sort of reassurance.

What is needed, experts say, is a commitment from an organisation such as the World Bank to provide the hundreds of millions of dollars needed to buy ACT, and a centralised global purchasing body to co-

ordinate the orders. As the Chinese proverb has it, “He who plants a garden, plants happiness.” With enough money, and better co-ordination, the world could have a bumper harvest of *Artemisia*—which would be good for poor farmers in China and poor patients in Africa too.

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Medical ethics

Big sister is watching you

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Virtual chaperones may help both doctors and patients

IF YOU can't trust a doctor, who can you trust? Sadly, though, neither doctors nor patients are always trustworthy. That leads to abuses by the former during intimate examinations, and false accusations of abuse by the latter in the hope of making large sums of compensation money. To combat both phenomena, Britain's National Health Service (NHS) is considering a plan to force doctors to have a nurse present as a chaperone in any situation with the potential to turn compromising.

That, however, replaces one problem with another. Chaperoning is hardly the best use of a nurse's talents, even when lots of nurses are available. And at the moment the NHS has a serious shortage of nurses. However, a team led by Sir Ara Darzi, of the Imperial College School of Medicine, in London, may have come up with the answer—an electronic chaperone.

Like a maiden aunt at a Victorian date, the Synaptiq Virtual Chaperone, so named after the firm that makes it, is discreet, but omnipresent. A camera mounted on the ceiling in the corner of the consulting room has a viewing angle of 120°—enough to see what is going on everywhere—while a microphone records the conversation between doctor and patient. The equipment is barely visible. This should help to avoid the tendency which many people have to play to the camera. But the system is discreet in another way, too. The data it collects are encoded immediately, using a level of security more frequently associated with financial institutions than doctors' surgeries.

And those data are there for clinical as well as legal reasons. For there is a third element to the system, a console on the doctor's desk that can be used to record medical information about the patient. That means there is a complete record of the consultation that both patient and doctor, who each receive a copy, can refer to in order to jog their memories about the facts. To decode the recording requires a special key that fits into a computer's USB port, and also a password, so unauthorised access is easy to prevent unless both key and password fall into the wrong hands.

A trial of the system, carried out in the plastic-surgery department of Charing Cross Hospital, in London, has yielded positive results. Some 96% of patients said that having the virtual chaperone enhanced their relationship with the doctor. The NHS's managers are also keen on the system. At the moment, the average time needed to settle a claim of misbehaviour in the consulting room is eight years. Many innocent doctors are suspended as a result (in 70% of cases, the doctor is cleared). An unambiguous record of what happened should stop that, and also prevent money being wasted on protracted court battles, since such cases will no longer turn on one party's word rather than another's. The virtual chaperone, in other words, may soon become virtually indispensable.

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Spaceflight

The sparks fly

Nov 18th 2004
From The Economist print edition

Electric propulsion is transforming space exploration

TWO speed records were set this week. On November 16th, the X-43A, an unmanned American aeroplane, became the fastest air-breathing craft in history—travelling at 11,300kph, or just under ten times the speed of sound. On the same day, the European *SMART-1* probe (also unmanned) reached the moon, becoming the slowest spacecraft ever to make the trip—it took 13 months. But, surprisingly, this second record is the more significant of the two.

The X-43A, designed to test an advanced type of engine called a scramjet, flew under its own power for only ten seconds. The eventual goal is to revolutionise travel within the Earth's atmosphere, and the test may indeed lead one day to such a revolution. But flights from New York to Tokyo in an hour are still a long way off. *SMART-1*, on the other hand, is part of the vanguard of a way of propelling spacecraft that is already changing and cheapening the business of space travel.

SMART-1 will orbit and study the moon in coming months. Probably, it will not find anything very surprising—but that does not matter, for what is really interesting is how it got there. *SMART-1* is propelled by plasma thrusters. These are devices that throw electrically charged atoms (in this case xenon nuclei) out of the back of the engine at speeds of around 16km a second. Like the exhaust of a more conventional rocket, this action generates an equal and opposite reaction, which pushes the spacecraft forward.

Electrically propelled rocket motors such as this (and several different sorts are in development) are already used to keep communications satellites “on station”. They are between five and 20 times as efficient as conventional chemical rockets, and that makes them attractive for deep-space missions as well. Because the thrust they generate is low compared with conventional rockets, they cannot be used until a probe is already out in space. But once there, their efficiency, combined with the fact that they can run for months at a time, means that they can actually end up going much faster than conventionally powered craft. An electrically powered mission to Pluto, for instance, could get there in just seven years. A conventional rocket would have trouble doing so in 20.

In this context, taking 13 months to get to the moon sounds rather dilatory. But compared with those being planned, *SMART-1* was a low-thrust mission. As its name suggests, electric propulsion requires electricity, which is in short supply in space. *SMART-1*, like *Deep Space-1*, an American probe which was launched in 1998 in order to test a different kind of electric thruster, relies on solar panels for this power. Over the past ten years, according to Roald Sagdeev, an expert in the field who works at the University of Maryland, College Park, the electricity supply available from solar panels has increased four-fold. That makes missions in the inner solar system viable. But the real heavy-lifting, the sort that could get a craft to Pluto—the planet farthest from the sun—would depend on placing small, uranium-powered nuclear reactors in space.

This, of course, is a controversial idea, which was examined in the 1970s and rejected. But placing a nuclear reactor in space is a safer idea than it sounds. Elaborate containment systems mean that even in the unlikely event that a rocket exploded on take-off, the uranium would, according to Dr Sagdeev, come to rest in a box on the bottom of the sea.

Whether that argument will persuade opponents remains to be seen, although existing deep-space missions often carry significant amounts of plutonium (used to generate electricity by radioactive decay, rather than nuclear fission) and nobody much complains. But, regardless of that, electrical thrusters have certainly become fashionable in the world's space agencies. *Dawn*, an American mission to the asteroids Ceres and Vesta, which is scheduled for launch in June 2006, will use solar-powered thrusters to get to

the asteroid belt. And the most ambitious mission currently on the drawing board, the *Jupiter Icy Moons Orbiter*, will, if all goes well, have nuclear-powered thrusters. That mission is not due to depart until 2015, so there is plenty of time to win objectors round—or not, as the case may be.

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Taxonomy

Invisible threads

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Bird-watchers need to look harder

Which one am I?

IT IS an ancient cliché that beauty is in the eye of the beholder. Actually, it isn't. Most people agree about who is beautiful and who is not. But that coincidence of human sensory perception can be misleading when the creature being appraised belongs to another species. Then, anthropocentric aesthetic judgments can just be plain wrong.

The reason is that not every eye sees the world in the same way. In particular, many species can see ultraviolet light, which is invisible to the human eye. And Robert Bleiweiss, of the University of Wisconsin, Madison, has used that fact to suggest that human bird-watchers might be misclassifying the objects of their affection as a result.

Dr Bleiweiss has been looking at a group of Andean birds called the mountain tanagers—in particular the black-chinned and the blue-winged species of that group. To the human eye, the distinction between these species is, despite their names, that the former has an olive-coloured back and the latter a black-coloured back. But this classification does not work very well, since in some places (though not in others), olive-backed and black-backed tanagers will interbreed. Since the definition of separate species is that they will not interbreed in the wild (even though closely related species can often be persuaded to do so in captivity), that, as it were, threw the cat among the tanagers.

Dr Bleiweiss, however, decided to take a bird's eye, rather than a human's eye look at the question. He examined a series of specimens taken from various parts of the tanagers' range by photographing them in ultraviolet light. He found, as he describes in a paper in the *Proceedings of the National Academy of Sciences*, that some of the birds were also ultraviolet-backed. Looking at where these birds came from he realised that this was the true distinguishing feature between the species. Black-chinned tanagers are also ultraviolet backed. Blue-winged mountain tanagers, whether black-backed or olive-backed, are not. And if that sort of result is repeated elsewhere, bird-watchers the world over are now going to have to equip themselves with ultraviolet-sensitive film if they want to carry their hobby to its logical conclusion.

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Museum of Modern Art

Bring on the new

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AP

It has been a wait, but the transformation runs deep

JOAN MIRO, Spain's surrealist painter, next to Auguste Rodin's 1898 bronze “Monument to Balzac”; Barnett Newman's rusted steel sculpture of a kissing pyramid and inverted obelisk in front of Claude Monet's “Water Lilies”? The Museum of Modern Art (MoMA) is back, taking risks like the teenager it was several buildings ago. After three years in a bunker in the borough of Queens, the museum re-opens in midtown Manhattan on November 20th, with a gleaming new tower designed by Yoshio Taniguchi. The renovation has provided a reason to unify all the architectural additions of the museum's 75-year history, while the museum's exhibition space has increased by half, to 125,000 square feet (11,600 square metres).

Plenty of people were taken by surprise by the choice of a Japanese architect not well known in America, though Mr Taniguchi's subtle designs include a host of Japanese museums. A design from a more worldly architect—Frank Gehry, say, or Rem Koolhaas—would have been in line with a trend favouring signature buildings for famous museums. Yet MoMA is no Guggenheim in Bilbao; it has no need to use fantastical architecture to compensate for a thinly spread collection. Here, it is all about the art on the inside.

Mr Taniguchi's building is in the service of beauty. The materials and structures play with natural light, and the visitor is constantly refreshed, either by views on to the Abby Aldrich Rockefeller Sculpture Garden or through artfully placed full-length windows. Often, you need to turn on the spot in order to appreciate the effect of both interior and exterior sightlines.

And then there are the exhibition spaces. With the museum's vast and varied collection, the rooms could have gone on for ever. Instead, MoMA and Mr Taniguchi have created a series of galleries that attempt to tell the story of modern art, as well as spaces designed for flexibility. A room on the third floor that currently shows Jackson Pollock's drip paintings will be re-arranged next autumn to showcase another artist—Newman, perhaps, or Mark Rothko. Nearby space will allow for canonical works by these artists always to be on view. Yet the flexibility of the “Pollock room” allows the museum to show off the depth of its holdings. This dynamic approach to display is ambitious.

The rehang in general was an enormous project, and the results are mixed. It is a relatively simple matter for the visitor to pick and choose from different eras, or seek out particular artists. The top floors contain painting and sculpture and follow historical periods. The second floor houses photography, drawings, and architecture and design. In a strong signal, the contemporary galleries are housed on the expansive first floor, also the most accessible.

Magical moments occur. For example, Egon Schiele's austere, cream-and-gold “Portrait of Gerti Schiele”, completed in 1909, sits next to Gustav Klimt's glowing painting of a bare-breasted woman, from 1908. Who knew these two artists could walk the same aesthetic line with such different results? Even MoMA's familiar Matisse room tingles with the addition of “The Yellow Curtain”, painted in 1915. The curators have clearly had fun in their attempt to lay out the historical narrative of modern art, with all its circuitous routes.

In the contemporary galleries, this museum is still a “work in progress”, as the museum director, Glenn Lowry, and the chief curator of painting and sculpture, John Elderfield, both put it. Themes are suggested but do not add up to much, and the connection between Gordon Matta-Clark's “Bingo”, three distinct vertical sections of a derelict house, and one of Cy Twombly's blackboard paintings is hard to fathom. Similarly, very recent acquisitions are at times awkwardly introduced into a group with which they have no apparent connection, aesthetic or conceptual. A moment of respite from such disjointedness is the placement of Rachel Whiteread's lovely, impenetrable plaster cast of a room's interior in the foreground of Toba Khedoori's work “Untitled (Doors)”, made with wax on wallpaper-like sheets.

Clearly, this floor will be the one that changes most often, as MoMA experiments with its stated role as a promoter of contemporary art. The museum has the work to do this successfully, Mr Elderfield says. Even though pieces on view tend towards the more accepted blockbusters of the early eras of modern art, by quantity MoMA's collection is heavily weighted towards more recent decades. Both the large space for contemporary exhibitions, along with such new additions as the well-appointed projection room dedicated to video art, bode well.

Yet any museum relies for its success chiefly upon the instincts and expertise of its curators. On this score, MoMA has talent in abundance. Mr Elderfield has already stirred the pot with his fresh arrangements in the museum's public spaces. Those hoping to return to a familiar, comfortable Modern will be surprised, even shaken, but perhaps also stirred.

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About sponsorship

Flogging culture to Americans

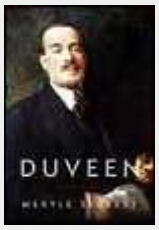
The art of the deal

Nov 18th 2004
From The Economist print edition

THE half-century between the 1880s and the Wall Street crash of 1929 saw one of the most remarkable migrations of cultural artefacts. In unprecedented quantities, Old Master paintings, sculpture, furniture, silver, Chinese porcelain, altarpieces, books and manuscripts, medieval architecture, clocks and carpets were shipped from Europe to the United States.

This was not the booty of war, but rather a seismic shift in the world economy. In the late 19th century, European agricultural revenues collapsed as imported grain from America—and the discovery of oil there—caused steep falls in food prices. The land-rich families of the British and European aristocracy, who owned most of Europe's cultural treasures, faced mounting debts and even economic ruin. The new rich were Americans who marked their ascendancy with the trappings of fine art from the lands of their forefathers.

Duveen: A Life in Art
By Meryle Secrest



Knopf; 517 pages; $35

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The Europeans sold; the Americans bought. The new collections formed the basis of the great American museum collections we know today. The scale of the enterprise, even early on, was something to be reckoned with. When John Pierpont Morgan died in 1913, his art collection was valued at $60m. These and similar collections would be worth billions today.

The buyers were urged on in their purchases by a small group of art dealers that included Knoedler, Colnaghi and Agnew's. At a time when well-illustrated books and sales catalogues did not exist, collectors were almost entirely dependent on art dealers for advice. Often, these were the only people who had actually seen the paintings in question.

Hated as much as he was admired, the leader of the pack was Joseph (later Lord) Duveen, descendant of a family of Dutch Jews who had started out selling Delftware. Duveen's secret was to mark out which of his American collector-clients would be bestowed the honour of being allowed to buy a painting or sculpture. This he managed to do in bulk. As Meryle Secrest shows in the first biography of Duveen in half a century, “every autumn the London branch [of Duveen brothers] sent to the New York branch almost 300 cases a week for something like six weeks.” Runners were posted all over Europe seeking out fresh artworks, and Duveen's Old Masters were often given impeccable attributions by the leading scholar-aesthete of the day, Bernard Berenson.

Annual profits from Duveen's New York enterprise reached over £500,000 by 1895, and the holdings were so extensive that the company spent years trying to trace one of the great Italian masterpieces, Giovanni Bellini's “Virgin and Child in a Landscape”, not realising that the firm owned the painting already. It had been bought for just £1,200.

An elegant 1952 biography by S.N. Behrman went a long way toward persuading the public that this triumph was due entirely to Duveen's enthusiasm and legendary capacity for hard work. Today, the paintings he bought and sold are still often known as “Duveens”. Only in 2002—after the Duveen archive, which had been allowed to pass into the hands of the Getty Trust in Los Angeles, was finally catalogued and microfilmed—were scholars able to check the record against Duveen's account of the years of plenty.

Ms Secrest's work is the first biography since the archive became available, and for that reason alone the work she has done is invaluable. She makes it clear that Duveen, though powerful, was just one of a number of dealers for Americans at that time.

Moreover, even though Andrew Mellon once mordantly remarked, “Lord Duveen, my pictures never look

so marvellous as when you are here," Duveen never quite relied on mere professional enthusiasm as much as he would have had you believe. He employed scouts to follow potential clients, bribe their butlers and sort through their bins, all in an effort to collect any scrap that might prove useful to a sale. He could quite happily trash a painting being sold by another dealer, and indeed was sued three times for slander.

Although Ms Secrest believes Duveen never went quite so far as knowingly to sell a rich client a fake, he sailed close to the wind. His relationship with Berenson, far from being as independent as Duveen's clients believed, was financially close. Not only was Berenson paid a large retainer by Duveen, he often took a commission from a sale whose size depended on the attribution he gave to a painting. What is most surprising is how many paintings Duveen sold that turned out not to be masterpieces at all, but cheap imitations. The list at the back of the book runs to 95 pages.

There are small quibbles. The book's index appears to be incomplete, and the editing is odd in places. One chapter that begins with a description of Duveen's relationship with Henry Clay Frick, who in his old age became one of Duveen's most important clients, directly follows another that ends with an account of the sinking of the *Lusitania* in the spring of 1915. Yet Ms Secrest fails to mention here that Frick had just completed the purchase of Titian's "Man in a Red Cap" from Sir Hugh Lane, when the baronet went down aboard the Cunard liner.

Happily, these infelicities are few. Perhaps the book, ultimately, is rather dull. Yet this has less to do with Ms Secrest's abilities, which are considerable, and more to do with the nature of the man and the material at hand. Although he was a great raconteur, Duveen does not appear to have been a very inspiring or interesting man, other than when he was working. At bottom, Lord Duveen was vain, greedy and mightily pleased with himself, the sort of man one is rather glad to have met only in the pages of a book.

Duveen: A Life in Art.
By Meryle Secrest.
Knopf; 517 pages; $35

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About sponsorship

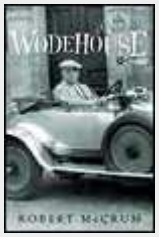
P.G. Wodehouse

Rum cove, really

Nov 18th 2004
From The Economist print edition

A GOOD test of almost any book is to ask whether one would not be better off reading a work by P.G. Wodehouse, and the answer, in this reviewer's opinion, is nearly always “Yes.” Robert McCrum, however, has written a book that provokes the answer “Perhaps not.” This is high praise indeed.

Wodehouse: A Life
By Robert McCrum



Norton; 384 pages; $27.95. Viking; £20

Buy it at
Amazon.com
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In many respects Wodehouse was a deeply ordinary man. Born, in 1881, into a “good” family of colonial administrators, he was brought up in England, largely under the auspices of nannies, relations and schoolmasters. Between the ages of three and 15, he saw his parents, who were doing their bit for the empire in Hong Kong, for a total of barely six months. Starved of maternal affection, he grew to treat emotions as dangerous but discovered that sport, and animals, could be substitutes of a kind. Fortunately, school, in particular his public (ie, secondary) school, Dulwich College, was wonderful. Here, for six happy years, he learnt classics, developed a passion for grammar and became something of an athlete. But he emerged a shy young man with few friends, whose hopes of going on to Oxford were dashed when his father, somewhat inexplicably, pleaded poverty. Instead, Wodehouse entered a bank, which he loathed.

The very unordinary aspect of Wodehouse's character was his response to an upbringing that was quite typical for young men of his class and circumstances. Instead of a conventional marriage and a conventional career, or even a conventional death in the first world war, he turned to writing, first about the things he knew well—school, life in a bank—then increasingly about an invented version of the Edwardian world in which he had spent his formative years. This imaginary world was the one that Wodehouse was, in many respects, to inhabit for the rest of his life, and that was to give so much pleasure to his millions of readers.

About most things, and most people, Wodehouse was detached. The exceptions were, first, writing, which was perhaps his greatest love. The second was Ethel, his wife, to whom he was devoted. The third was Leonora, her daughter, whom he adopted, and adored. Leonora's death—in 1944, after a routine operation—was the private blow from which he never recovered. And by then Wodehouse had already suffered a devastating public blow, having done the “loony thing” that was to keep him out of England for the last 34 years of his life and blight his reputation for a generation. This was his readiness to make five broadcasts from Nazi Germany in 1941 about his experiences as an internee.

The hardest tasks for any Wodehouse biographer are the handling of his love life and the degree of culpability to assign to the broadcasting affair. Never flinching from either subject, though never dwelling unduly on the (absent) sex, Mr McCrum draws a picture that is entirely convincing. Wodehouse was clearly capable of love, and it was heterosexual, not homosexual love. But sex was not his thing: he and Ethel had separate bedrooms from the outset and, so far as is known, the pattern was broken only once, when a mouse ran across Ethel's bed in the night, prompting her to call him in to repel boarders.

Just as Wodehouse was evidently asexual, so he was “aworldly”, that is, neither worldly nor unworldly, simply uninterested in what was going on around him. He was never completely cut off from reality: he was quite capable, as a young man, of making money doing the conventional stuff of journalism—writing about events—and even in the 1930s he could see the ridiculousness, if not the odiousness, of fascism. But he could not take international politics seriously: it was all a sort of game, of the kind played at school, and a war was simply an away game. Though neither wholly innocent nor wholly naive, he could not see the folly, the sheer bad taste, of making frivolous broadcasts from Berlin when the concentration camps were filling up and his country faced defeat at the hands of the Germans. But did that make

Wodehouse pro-Nazi, a collaborator or a traitor? No, no, no; just a fool.

All this Mr McCrum deals with persuasively. If he never quite makes the reader love Wodehouse, that is his subject's fault. Wodehouse was good-natured, eager to please and usually liked. But he was also buttoned up, money-conscious, capable of strange ingratitude and, most disappointingly, never at all funny in conversation. Mr McCrum emphasises Wodehouse's under-appreciated contribution to musical comedy, and of course he pays just tribute to his much better known contribution to literature. If, at the end of it all, the reader still wonders at the link between character and genius, it is the wonderment of awe, not of incomprehension. This biography is unlikely to be bettered.

Wodehouse: A Life.
By Robert McCrum.
Norton; 384 pages; $27.95. Viking; £20

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Woody Guthrie and Bob Dylan

I felt so symbolic yesterday

Nov 18th 2004
From The Economist print edition

JOAN BAEZ, once Bob Dylan's lover, called him “the unwashed phenomenon, the original vagabond”. Unwashed and a vagabond, perhaps, but Mr Dylan wasn't the original one among American musicians, for that was Woody Guthrie. Unlike Mr Dylan, to whom success and fortune came at a young age, Guthrie never really got on a sound financial footing. This, as much as anything, marks the difference between the two men.

“Chronicles”, the first volume of Mr Dylan's autobiography, is an attempt to tell how the boy became an artist. It is a humble book, and it demystifies the man. Still, it is worth recalling what Ed Cray says about Guthrie's own autobiography, “Bound for Glory”: it is heavily embellished and retouched. Is it possible that the same could have happened with Mr Dylan? His account of his going to meet Guthrie, who was close to death, differs considerably from Mr Cray's.

The heart of “Chronicles” has to do with Mr Dylan in his formative years, and is a catalogue of influences and fellow Americans, now largely forgotten. Mr Dylan's appraisals are heartfelt, and are a pleasure to read. The memoir is an evocation of an unreclaimable time, in this instance of Greenwich Village in the early 1960s. Regrettably, a long section in the middle of the book then recounts a recording session in New Orleans in 1987. It is in this part that Mr Dylan's self-seriousness gets the better of him. None but die-hard fans will be interested in reading about how he made a mediocre record.

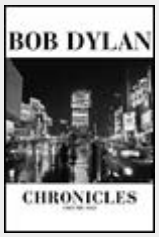
There is a striking absence in the book of Mr Dylan's lyrics. He focuses instead on the music itself. This is wise, since his lyrics, like Guthrie's, do not have the art to stand alone as poems. Both men wrote wonderful songs, but they are just that.

If there were any doubt about Guthrie and his words, it is laid to rest in the pages of Mr Cray's thoroughly readable account of Guthrie's life. Sprinkled throughout are the lyrics of very good songs that sadly lie dead on the page. Mr Cray handles very well Guthrie's politics (leftish) and his times (difficult). Yet in a book which, after all, is about a musician, it is disappointing to find that there is not more about the music. Guthrie's picaresque life makes for captivating reading, but Mr Cray's omission would make a reader otherwise ignorant of Guthrie wonder what all the fuss was about.

If Mr Dylan was prolific, Guthrie was a torrent of words and music. He could write songs just about as fast as he could sing them. Part of the reason for this is repetitive choruses: “I ain't dead!/I ain't dead!/I ain't dead...” Yet he is, and that is a pity. As Mr Dylan wrote of him in one of his earliest compositions: “there's not many men that done the things that you've done.”

To succeed fully as an artistic testament, “Chronicles” would have had to come to terms with the unevenness of Mr Dylan's output, for the best of it is genius but the vast majority is not. In this, the bard's book fails, and so does “Studio A”, an anthology of essays about him. The selection is arbitrary. Some of the longer essays, for instance, by Clive James and Alex Ross, are gems of music journalism, but the anthology also includes fourth-rate poems dedicated to Mr Dylan, as well as long, pointless biographical notes about the contributors. The

Chronicles: Volume One
By Bob Dylan



Simon & Schuster; 293 pages; $24 and £16.99

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Studio A: The Bob Dylan Reader
Edited by Benjamin Hedin

Norton; 336 pages; $24.95 and £17.99

Buy it at
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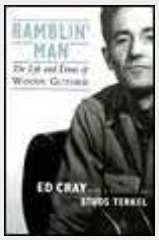
Ramblin' Man: The Life and Times of Woody Guthrie
By Ed Cray



Norton; 488 pages; $29.95 and £18.99

Buy it at
Amazon.com

book as a whole is symptomatic of what is wrong with the study of Mr Dylan—it is possible to say a great deal without meaning anything at all.

Amazon.co.uk

Chronicles: Volume One.
By Bob Dylan.
Simon & Schuster; 293 pages; $24 and £16.99

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About sponsorship

Naval history

Putting the sea back in Britain

Nov 18th 2004
From The Economist print edition

NICHOLAS RODGER is a professor with a mission: nothing less than “to put naval affairs back into the history of Britain”. And in this book he succeeds triumphantly. “The Command of the Ocean” is the second in a planned three-part series. The first, “The Safeguard of the Sea”, covering the period 660-1649, appeared seven years ago to a 21-gun salute from the critics; the present volume brings the story up to 1815 and deserves the same.

The Command of the Ocean: A Naval History of Britain, 1649-1815
By N.A.M. Rodger

Penguin/Allen Lane; 907 pages; £30

Buy it at Amazon.co.uk

It is a book of impressive scholarship and intellectual versatility. Conducting his research in 11 languages, Mr Rodger is able to digress seamlessly from naval affairs to make informed, and always pertinent, points about geography, politics, economics and more. So, for example, he traces in authoritative detail the development of Britain's fiscal system and shows how, without it, the country could never have sustained such a hugely expensive enterprise as a standing navy—in marked contrast to its two main European rivals, France and Spain, whose precarious finances were constantly threatened by the cost of their navies.

Indeed, Mr Rodger's informed understanding of the maritime history of the nations to which Britain found itself opposed is one of the most notable aspects of the book, setting it apart from rivals. It tells a genuinely international story; repeatedly, this broad view challenges, and refreshes, the essentially Anglocentric narratives that have served for so long.

All the same, Mr Rodger carries his scholarship lightly. Throughout, the book is written in an accessible style, enlivened with flashes of wit. So, for example, commenting on the exaggerated figures given in some modern works for the numbers of deaths from scurvy, Mr Rodger remarks that, if they are to be believed, “every man who ever served in the Navy died of scurvy approximately twice.”

The book is particularly insightful in its study of social history. The author, after all, was the first to challenge the hoary myths about appalling social conditions in the Royal Navy of the 18th century, in his ground-breaking book, “The Wooden World”, published nearly two decades ago. Yet that was a highly focused study, dealing only with the period of the Seven Years War. Now, Mr Rodger ranges over 160 years with equal authority, dispelling yet more myths in the process, including some new ones. His analysis of the cause of the 1797 mutinies, and his demolition of the increasingly preposterous conspiracy theories that have emerged of late, is both masterly and entertaining. Regarding the idea that there must have been some mysterious genius who organised the mutiny at Spithead, but who covered his tracks so well that he can no longer be traced, Mr Rodger concludes that: “we are in the presence of the conspiracy theory in its purest form in which the entire lack of evidence only serves to prove the fiendish cunning of the conspirators.”

If the book is strong on social and administrative history, the great battles are not neglected. Here, too, Mr Rodger challenges old myths. The “line of battle” was never as rigid and as neat as the carefully drawn plans in the tactical textbooks have led us to believe. The late 18th-century navies were far more innovative tactically than the old naval histories used to suggest. So, Nelson's battle plans were not the work of a lone revolutionary genius, but were the product of cumulative experimentation—and as much by the French as by the British.

When the drama of the narrative requires it, the author rises to the occasion with vivid descriptions: as, for example, when Edward Hawke chases the French fleet into the dangerous waters of Quiberon Bay, in the fast fading light of a November afternoon in 1759.

The main text is supported by an impressive array of appendices, “notes on conventions” and plans. The bibliography is worth reading in its own right for the wickedly caustic judgments on some of the featured works. Over two-thirds of the material quoted dates from after 1970. This is a striking demonstration of a recent surge of scholarly interest in naval history, and of its increasing influence on mainstream British historical studies. It is an influence, perhaps, that Mr Rodger himself has done more than any other scholar to bring about.

The book itself has been handsomely produced, printed in a clear, attractive typeface and lavishly illustrated. Author and publisher have benefited from the National Maritime Museum's involvement with the project. The 56 images, all drawn from the museum's collections, include a number of unfamiliar and fascinating prints and paintings. The same level of scholarship has been applied to the picture selection, it seems, as to the text.

This emphatically is not a book just for students of naval history. It places the sea squarely where it belongs: at the very heart of the island's story. As such it should be essential reading for all interested in that story. As Mr Rodger demonstrates on almost every page, if you do not understand the importance of British maritime history, you can never fully understand Britain.

The Command of the Ocean: A Naval History of Britain, 1649-1815.
By N.A.M. Rodger.
Penguin/Allen Lane; 907 pages; £30

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About sponsorship

Obituary

Sheikh Zayed

Nov 18th 2004
From The Economist print edition

Sheikh Zayed bin Sultan al-Nahayan, ruler of Abu Dhabi and president of the United Arab Emirates, died on November 2nd, aged 87

EPA

THIRTY-EIGHT years on the throne, Sheikh Zayed was every inch the great Arab patriarch. It was not simply that his reign was long, peaceful and prosperous. The sheikh oversaw the seemingly magical transformation of his realm from a dusty and dirt-poor desert emirate into a booming city-state, a mirage-like place of boulevards, towers and emerald parks. And his magic was not confined to Abu Dhabi. After Britain's exit from the Gulf in the 1960s, he coaxed and cajoled the rulers of six other principalities strung along its southern shore to join in the federation known as the United Arab Emirates.

As president of the union from its founding in 1971 until his death, he wielded fabled diplomatic skill as well as generosity. Sharing freely of Abu Dhabi's huge oil riches to bolster the federation's smaller emirates, he also invested in wider Arab causes. It was at his urging that five other Arab monarchies joined the UAE to form a regional group, the Gulf Co-operation Council, in 1981. Over four decades, Sheikh Zayed directed billions of dollars in aid to no fewer than 40 poorer countries. Egypt alone has two model cities named after the sheikh, as well as a giant canal that feeds Nile water to a vast desert-reclamation scheme.

Of course, it was Abu Dhabi's immense oil wealth that enabled the sheikh to provide such a legacy. Before it started to export oil in 1962, the territory was known for nothing much more than exotic postage stamps, fish, camels and the big slave market at the oasis of Al Ain. The main landmark in the little town of Abu Dhabi itself (population 15,000) was a single, scraggy acacia tree, and the only reliable means of transport to neighbouring Dubai and Sharjah was wooden-hulled dhows.

The al-Nahayans, who had ruled Abu Dhabi since the late 18th century, were hardly better off than their barefoot subjects. Sheikh Zayed himself received no formal education. While serving as the emir's representative in Al Ain during the 1926-66 reign of his elder brother, Shakhbut, the future emir grew to love the oasis's palm trees and the traditional desert pursuits of falconry, shooting and camel racing. He also accompanied early oil prospectors around Abu Dhabi, an experience that made him so curious about western ways that he embarked on extensive tours of Europe and America in the 1950s.

When the oil began to flow in the 1960s, impatient members of his family, as well as Britain's Foreign

Office, prevailed on him to ease his spendthrift and dithering brother out of office. Independence for Abu Dhabi in 1971 was followed swiftly by the oil-price increases of 1973, generating an immense windfall for the al-Nahayans. By the 1990s, when Abu Dhabi's oil exports per citizen were running at over $50,000 a year, the sheikh's personal fortune was put at some $20 billion. Unlike other Gulf rulers, however, Sheikh Zayed lived modestly, reserving a special passion for palms. About 100m trees were planted during his reign, in what he saw as a far-sighted investment for the oil-less future.

Charming, too

With dark, chiselled features, a conspiratorial glint in his eye and a magnificently easy smile, Abu Dhabi's ruler looked like a movie sheikh from the days when Hollywood was kind to Arabs. He was always gracious, self-deprecating and attractively self-confident, once telling a reporter, with a wink, that he really preferred to meet his subjects himself—"since my secret police get it wrong half the time."

The country he ran was, by the standards of the region, a model of tolerance, probity and decent government. The loose federal system devised by Sheikh Zayed allowed each emirate to develop its own style, even as Abu Dhabi underwrote the building of its excellent infrastructure. He saw early on that the UAE's small population would hold back progress. As a result, immigrants, many of them from the Indian subcontinent, now make up more than three-quarters of the federation's 4m people. He also recognised the difficulty of defending the thinly populated territory, and forged close ties with both his immediate neighbours and the United States.

Some embarrassment has arisen from Sheikh Zayed's 19 sons, several of whom have gained a reputation for raucous or violent behaviour. And the judgment of the sheikh himself has not always been sound, especially in recent years. Financial scandals, such as the collapse of the Bank of Credit and Commerce International in 1991, have occurred in Abu Dhabi with some frequency; money-laundering and the financing of terrorism have also come to light. The UAE was one of only three countries to recognise the Taliban government in Afghanistan, and it remains one of the least democratic of countries in a democracy-poor region. It was only recently, during Sheikh Zayed's final incapacitation, that it got its first female cabinet minister.

Yet none of this has tarnished the sheikh's reputation at home. With so few and such pampered citizens, the UAE is not under much pressure to democratise. Despite fears of trouble over his succession, the installation of his eldest son, Sheikh Khalifa bin Zayed, as both emir of Abu Dhabi and president of the UAE has been smooth. In short, Sheikh Zayed was that rarity in Arab countries, a leader truly loved and admired by his subjects.

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Overview

Nov 18th 2004
From The Economist print edition

Inflation worries returned to **America**. Consumer prices jumped by a higher-than-expected 0.6% in October, up from a rise of 0.2% in September. Higher energy prices were largely to blame. In the year to October, consumer-price inflation ran at 3.2%, compared with 2.0% in the year to October 2003. Core inflation (which excludes the volatile prices of energy and food) also climbed, though less dramatically, by 0.2% during the month, to give a 12-month increase of 2.0%. Producer prices are also on the march. They rose in October by 1.7%, the biggest monthly increase in almost 15 years. Prices of food and energy made up most of the rise.

America's industrial production rose by 0.7% in October, more than double the expected increase. Over the 12 months, industrial output was up by a healthy 5.2%.

Economic growth in the **euro area** is slowing. GDP growth fell to 1.2% at an annual rate in the third quarter, down from 2.0% in the second quarter. Growth in industrial production, however, quickened, growing by 2.9% in the year to September, up from 1.8% in the year to August. Consumer-price inflation in the euro area rose by 0.3% in October, and by 2.4% in the year to October.

France's economy, which had until recently been one of the euro area's stronger performers, virtually stalled in the third quarter, with GDP growth of only 0.4% at an annual rate. **Italy's** economy, by contrast, perked up, with annualised growth of 1.7%. But in the year to September, its industrial production rose by only 0.8%.

Italy's 12-month trade surplus narrowed from $3.1 billion in August to $2.4 billion in September. Over the same two months, the 12-month trade surplus widened in the **Netherlands** from $34.4 billion to $35 billion. **Spain's** 12-month current-account deficit widened from $35.8 billion in July to $38.5 billion in August.

Retail sales in **Japan** fell by 0.4% in the year to September.

Britain's consumer prices rose by 1.2% in the year to October, up from 1.1% in the year to September. Its unemployment rate fell to 4.6% in the three months to September.

Retail sales in **Australia** grew by 5.7% in the year to the third quarter, down from a rate of 7.9% in the year to the second quarter.

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Output, demand and jobs

Nov 18th 2004
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2004	2005	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 4.1	Q2	+ 2.5	+ 3.6	+ 3.2	+ 4.6	Q2	+ 5.7	Q3	5.3	Oct	5.9
Austria	+ 1.8	Q2	+ 3.5	+ 1.6	+ 2.1	+ 9.5	Aug	+ 3.2	Aug	4.5	Oct	4.6
Belgium	+ 3.0	Q3	+ 3.2	+ 2.4	+ 2.1	+ 0.9	Sep	+ 0.9	Aug	13.2	Oct†	12.9
Britain	+ 3.0	Q3	+ 1.5	+ 3.2	+ 2.5	– 0.9	Sep	+ 6.0	Oct	4.6	Sep††	5.0
Canada	+ 3.0	Q2	+ 4.3	+ 3.0	+ 3.3	+ 6.4	Aug	+ 2.4	Jul	7.1	Oct	7.6
Denmark	+ 2.6	Q2	+ 1.0	+ 2.3	+ 2.3	– 2.6	Sep	+ 4.2	Sep	6.3	Sep	6.3
France	+ 2.1	Q3	+ 0.4	+ 2.4	+ 2.2	+ 2.9	Sep	+ 1.0	Aug	9.9	Sep	9.9
Germany	+ 1.3	Q3	+ 0.4	+ 1.5	+ 1.6	+ 2.5	Sep	– 1.4	Sep	10.7	Oct§	10.5
Italy	+ 1.3	Q3	+ 1.7	+ 1.1	+ 1.6	+ 0.8	Sep	– 4.0	Aug	8.1	Apr	8.7
Japan	+ 3.9	Q3	+ 0.3	+ 4.3	+ 2.1	+ 3.8	Sep	– 0.4	Sep	4.6	Sep	5.1
Netherlands	+ 1.4	Q3	+ 0.8	+ 1.2	+ 1.6	– 0.6	Sep	– 0.7	Jun‡	6.3	Oct**	5.4
Spain	+ 2.6	Q3	+ 2.4	+ 2.6	+ 2.5	+ 3.9	Sep	+ 0.2	Sep	10.6	Sep	11.3
Sweden	+ 3.6	Q2	+ 4.0	+ 3.4	+ 2.9	+ 5.3	Sep	+ 5.2	Sep	5.8	Sep†	4.8
Switzerland	+ 2.0	Q2	+ 1.6	+ 1.8	+ 2.0	+ 4.3	Q2	– 0.3	Sep	3.7	Oct†	3.8
United States	+ 3.9	Q3	+ 3.7	+ 4.4	+ 3.4	+ 5.2	Oct	+ 6.3	Sep	5.5	Oct	6.0
Euro area	+ 1.9	Q3	+ 1.2	+ 1.8	+ 1.9	+ 2.9	Sep	nil	Sep	8.9	Sep	8.9
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 2.7	Q2	+ 2.9	na	na	+ 5.1	Sep	+ 3.8	Aug	7.2	Sep†	8.0
Greece	+ 3.9	Q2	– 0.6	na	na	– 0.5	Aug	+ 6.6	Jul	na		na
Iceland	+ 6.2	Q2	na	na	na	na		na		2.6	Sep†	2.7
Ireland	+ 4.1	Q2	na	na	na	–12.6	Aug	+ 4.5	Aug	4.4	Oct	4.6
Luxembourg	+ 2.12003		na	na	na	– 1.2	Dec	– 8.2	Sep	4.2	Sep	3.8
New Zealand	+ 6.0	Q2	+ 4.6	na	na	+ 5.5	Q2	+ 6.8	Q2	3.8	Q3	4.4
Norway	+ 4.1	Q2	+ 5.0	na	na	– 3.3	Sep	+ 2.0	Sep	3.7	Oct‡	3.8
Portugal	+ 1.5	Q2	+ 4.7	na	na	– 3.6	Sep	+ 3.6	Sep	6.3	Q2†	6.1

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡New series. ††Jul-Sep; claimant count rate 2.7% in Oct. §EU harmonised rate 9.9% in Oct. **Aug-Oct.

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Prices and wages

Nov 18th 2004
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2004	2005	latest		year ago	latest		year ago
Australia	+ 2.3	Q3	+ 2.6	+ 2.5	+ 2.7	+ 6.1	Q3	– 0.1	+ 2.9	Q2	+ 5.5
Austria	+ 2.6	Oct	+ 1.0	+ 1.7	+ 1.6	+ 6.0	Oct	+ 2.0	+ 2.0	Sep	+ 2.3
Belgium	+ 2.9	Oct	+ 1.6	+ 2.0	+ 1.8	+ 6.0	Sep	– 1.4	+ 2.2	Jul	+ 1.9
Britain	+ 1.2	Oct*	+ 1.4	+ 1.4	+ 1.7	+ 3.5	Oct	+ 1.5	+ 3.7	Sep†	+ 3.6
Canada	+ 1.8	Sep	+ 2.2	+ 2.0	+ 2.2	+ 4.6	Sep	– 2.7	+ 2.2	Aug	+ 3.5
Denmark	+ 1.7	Oct	+ 1.4	+ 1.2	+ 1.8	+ 3.6	Oct	nil	+ 2.9	Q3	+ 3.7
France	+ 2.1	Oct	+ 2.2	+ 2.3	+ 1.7	+ 3.1	Sep	+ 0.1	+ 2.7	Q3	+ 2.9
Germany	+ 2.0	Oct	+ 1.2	+ 1.8	+ 1.4	+ 4.2	Oct	+ 0.6	+ 1.5	Aug	+ 2.0
Italy	+ 2.0	Oct	+ 2.6	+ 2.3	+ 2.1	+ 3.9	Sep	+ 1.0	+ 2.5	Sep	+ 2.7
Japan	nil	Sep	– 0.2	– 0.1	+ 0.1	+ 1.9	Oct	– 0.5	+ 0.7	Sep	+ 1.5
Netherlands	+ 1.4	Oct	+ 2.0	+ 1.4	+ 1.3	+ 6.0	Sep	– 0.3	+ 1.1	Sep	+ 2.6
Spain	+ 3.6	Oct	+ 2.7	+ 2.9	+ 2.8	+ 4.6	Sep	+ 0.8	+ 3.1	Q2	+ 4.2
Sweden	+ 0.8	Oct	+ 1.4	+ 0.7	+ 1.6	+ 2.1	Sep	– 1.5	+ 2.2	Aug	+ 3.3
Switzerland	+ 1.3	Oct	+ 0.5	+ 0.7	+ 1.1	+ 2.0	Oct	– 0.3	+ 1.4	2003	+ 1.8
United States	+ 3.2	Oct	+ 2.0	+ 2.6	+ 2.3	+ 4.4	Oct	+ 3.4	+ 2.6	Oct	+ 2.2
Euro area	+ 2.4	Oct	+ 2.0	+ 2.1	+ 1.8	+ 3.4	Sep	+ 1.1	+ 2.1	Q2	+ 3.3
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 0.9	Oct	+ 0.3	na	na	+ 3.0	Oct	– 0.9	+ 3.5	Q2	+ 4.4
Greece	+ 3.2	Oct	+ 3.2	na	na	+ 2.1	Aug	+ 2.2	na		na
Iceland	+ 3.8	Nov	+ 2.5	na	na	+ 5.6	Oct	+ 3.7	+ 5.3	Sep	+ 5.6
Ireland	+ 2.7	Oct	+ 2.3	na	na	– 0.8	Sep	– 7.8	+ 3.8	Q2	+ 8.0
Luxembourg	+ 2.5	Oct	+ 1.7	na	na	+15.0	Sep	+ 0.5	– 0.4	Dec	+ 0.7
New Zealand	+ 2.5	Q3	+ 1.5	na	na	+ 1.5	Q2	– 1.9	+ 2.2	Q3	+ 2.3
Norway	+ 1.4	Oct	+ 1.6	na	na	+24.1	Oct	+ 2.1	+ 4.5	Q2	+ 5.4
Portugal	+ 2.1	Oct	+ 3.0	na	na	+ 4.5	Sep	– 0.2	+ 1.4	Sep	– 1.8

*New series. RPI inflation rate 3.3% in Oct. †Jul-Sep.

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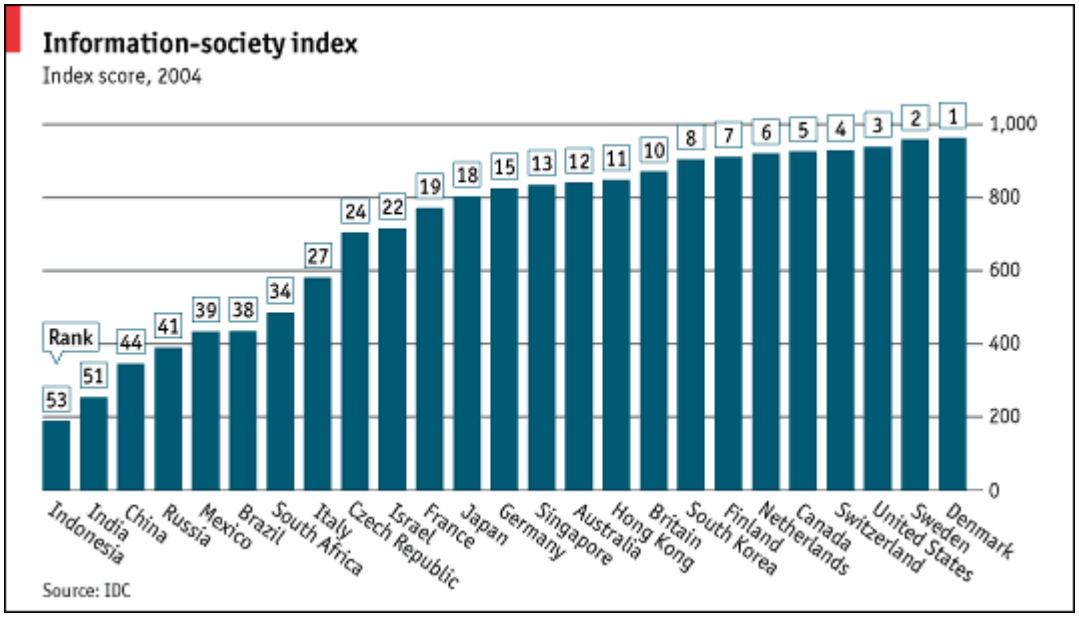
Information-society index

Nov 18th 2004
From The Economist print edition



Denmark leads the world as the country most open to information technology. America ranks third. The top Asian country is South Korea, in eighth place. China, 44th in the table, surpasses India, which comes 51st. The rankings are based on an index published by IDC, a research firm. It compares the use of computers, the internet and telecoms and also takes into account social factors that make countries open to IT.

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Money and interest rates

Nov 18th 2004
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Nov 17th 2004)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 4.2	+ 9.7	Sep	5.43	5.37	5.19	5.49	5.78	6.35
Britain	+ 5.9	+ 9.8	Oct	4.81	3.94	4.52	4.65	4.98	5.26
Canada	+11.3	+ 9.4	Sep	2.69	2.73	3.20	4.45	4.82	6.00
Denmark	+ 9.8	+10.7	Sep	2.25	2.18	2.49	3.81	4.47	5.24
Japan	+ 4.3	+ 2.1	Oct	0.02	0.02	0.11	1.48	1.31	1.56
Sweden	+ 1.6	+ 3.1	Sep	2.01	2.71	2.57	4.04	4.86	2.61
Switzerland	– 4.7	+ 0.4	Oct	0.77	0.24	1.05	2.37	2.71	2.36
United States	+ 4.6	+ 4.8	Oct	2.19	1.06	2.84	4.14	4.21	5.66
Euro area†	+ 9.7	+ 6.0	Sep	2.17	2.15	2.37	3.73	4.30	3.62

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 4.84%, Japan No.264 1.465%. Central bank rates: US fed funds 2.00%, ECB refinancing 2.00%, BOJ overnight call 0.001%, BOE repo 4.75%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Nov 18th 2004
From The Economist print edition

1995=100

	Nov 9th	Nov 16th*	% change on one month	% change on one year
Dollar index				
All items	86.6	88.4	+ 2.4	+ 0.6
Food	79.3	81.3	+ 1.6	– 7.3
Industrials				
All	96.6	98.1	+ 3.3	+11.3
Nfa†	81.4	82.2	+ 2.1	–10.2
Metals	109.5	111.5	+ 4.1	+30.7
Sterling index				
All items	73.6	75.2	– 0.3	– 7.7
Euro index				
All items	88.2	89.6	– 1.2	– 7.8
Yen index				
All items	97.5	99.1	– 0.5	– 2.0
Gold				
$ per oz	434.55	439.83	+ 4.8	+11.0
West Texas Intermediate				
$ per barrel	47.34	46.06	–13.3	+38.8

* Provisional. † Non-food agriculturals.

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Stockmarkets

Nov 18th 2004
From The Economist print edition

Market indices

	Nov 17th	2004 high	2004 low	% change on one week	% change on record high	% change on Dec 31st 2003 in local currency	% change on Dec 31st 2003 in $ terms
Australia (All Ordinaries)	3,889.9	3,890.9	3,274.9	+ 1.1	nil	+17.7	+22.2
Austria (ATX)	2,216.1	2,216.1	1,568.9	+ 1.4	nil	+43.4	+48.1
Belgium (Bel 20)	2,841.1	2,870.7	2,244.2	– 0.3	–22.8	+26.6	+30.7
Britain (FTSE 100)	4,795.9	4,803.1	4,287.0	+ 1.3	–30.8	+ 7.1	+11.1
Canada (Toronto Composite)	8,987.6	8,987.6	8,123.5	+ 1.7	–21.1	+ 9.3	+18.5
Denmark (KBX)	252.4	253.0	219.0	+ 0.6	–16.4	+18.2	+22.2
France (SBF 250)	2,623.2	2,623.3	2,386.1	+ 1.2	–40.3	+ 8.8	+12.3
(CAC 40)	3,844.1	3,844.1	3,465.3	+ 1.6	–44.5	+ 8.0	+11.6
Germany (DAX)	4,183.4	4,183.4	3,647.0	+ 2.3	–48.1	+ 5.5	+ 8.9
Italy (BCI)	1,402.6	1,403.7	1,239.5	+ 0.9	–35.7	+11.6	+15.3
Japan (Nikkei 225)	11,131.3	12,163.9	10,365.4	+ 1.2	–71.4	+ 4.3	+ 7.3
(Topix)	1,114.6	1,217.9	1,022.6	+ 1.3	–61.4	+ 6.8	+ 9.9
Netherlands (AEX)	342.2	364.8	310.7	+ 1.1	–51.2	+ 1.4	+ 4.7
Spain (Madrid SE)	909.7	909.7	804.4	+ 1.1	–20.6	+12.6	+16.3
Sweden (Affarsvarlden Gen)	220.6	220.6	188.5	+ 2.2	–44.9	+17.1	+22.3
Switzerland (Swiss Market)	5,681.5	5,934.4	5,309.7	+ 1.3	–32.5	+ 3.5	+ 9.8
United States (DJIA)	10,549.6	10,737.7	9,750.0	+ 1.6	–10.0	+ 0.9	+ 0.9
(S&P 500)	1,181.9	1,184.2	1,063.2	+ 1.6	–22.6	+ 6.3	+ 6.3
(NASDAQ Comp)	2,099.7	2,153.8	1,752.5	+ 3.2	–58.4	+ 4.8	+ 4.8
Europe (FTSE Eurotop 300)*	1,036.9	1,036.9	940.9	+ 1.5	–39.2	+ 8.2	+11.8
Euro area (FTSE Ebloc 100)*	887.8	888.3	787.2	+ 1.6	–42.7	+ 6.7	+10.2
World (MSCI)†	1,128.2	1,128.2	997.0	+ 2.1	–22.1	+ 8.9	+ 8.9
World bond market (Citigroup)‡	645.2	645.2	575.1	+ 1.7	nil	+ 6.9	+ 6.9

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in $ terms.
‡Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Nov 18th 2004
From The Economist print edition

	Trade balance*, $bn latest 12 months	Current-account balance $bn latest 12 mths	Current-account balance The Economist poll % of GDP, forecast 2004	Current-account balance The Economist poll % of GDP, forecast 2005	Exchange rate trade-weighted† 1990=100 Nov 17th	Exchange rate trade-weighted† 1990=100 year ago	Currency units per $ Nov 17th	Currency units per $ year ago	Currency units per £	Currency units per euro	Currency units per ¥100	Budget balance % of GDP 2004‡
Australia	− 17.0 Sep	− 34.2 Q2	− 5.8	− 5.3	88.7	86.5	1.28	1.38	2.37	1.66	1.23	+ 0.5
Austria	− 0.7 Aug	− 1.2 Aug	− 0.3	− 0.4	103.1§	102.6	0.77	0.84	1.43	–	0.74	− 1.3
Belgium	+ 20.5 Sep	+ 13.0 Jun	+ 3.3	+ 3.2	103.3§	102.7	0.77	0.84	1.43	–	0.74	− 0.2
Britain	−101.1 Sep	− 41.7 Q2	− 2.5	− 2.7	101.3	99.6	0.54	0.59	–	0.70	0.52	− 2.9
Canada	+ 50.2 Sep	+ 23.8 Q2	+ 2.8	+ 2.5	95.9	88.9	1.19	1.30	2.21	1.55	1.14	+ 1.2
Denmark	+ 9.8 Sep	+ 6.5 Sep	+ 2.9	+ 2.6	107.0	106.2	5.71	6.24	10.6	7.43	5.48	+ 0.9
France	− 2.8 Sep	− 2.3 Sep	+ 0.3	+ 0.3	106.8§	106.0	0.77	0.84	1.43	–	0.74	− 3.8
Germany	+186.4 Sep	+ 90.2 Sep	+ 3.2	+ 2.9	104.5§	103.5	0.77	0.84	1.43	–	0.74	− 3.7
Italy	+ 2.4 Sep	− 12.2 Aug	− 0.9	− 1.1	76.2§	75.5	0.77	0.84	1.43	–	0.74	− 3.1
Japan	+134.5 Sep	+169.0 Sep	+ 3.5	+ 3.5	137.2	136.6	104	109	193	136	–	− 7.1
Netherlands	+ 35.0 Sep	+ 21.0 Q3	+ 2.9	+ 3.0	102.8§	102.1	0.77	0.84	1.43	–	0.74	− 3.1
Spain	− 66.3 Aug	− 38.5 Aug	− 3.4	− 3.6	77.3§	76.9	0.77	0.84	1.43	–	0.74	+ 0.3
Sweden	+ 23.1 Sep	+ 23.4 Q2	+ 7.0	+ 6.4	83.5	82.6	6.89	7.53	12.8	8.98	6.62	+ 0.2
Switzerland	+ 7.9 Oct	+ 45.0 Q2	+11.3	+10.8	115.3	111.5	1.17	1.30	2.16	1.52	1.12	− 1.6
United States	−621.1 Sep	−571.9 Q2	− 5.5	− 5.4	90.4	97.6	–	–	1.86	1.30	0.96	− 4.7
Euro area	+106.4 Aug	+ 60.3 Aug	+ 0.6	+ 0.6	93.0	90.6	0.77	0.84	1.43	–	0.74	− 2.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 14.6 Sep	+ 8.6 Sep	na	na	82.2§	81.5	0.77	0.84	1.43	–	0.74	+ 1.6
Greece	− 29.6 Aug	− 10.9 Aug	na	na	59.7§	59.3	0.77	0.84	1.43	–	0.74	− 3.2
Iceland	− 0.4 Sep	− 0.6 Q2	na	na	96.1**	95.0	66.5	75.1	124	86.7	63.9	+ 0.2
Ireland	+ 42.5 Aug	− 1.7 Q2	na	na	94.8§	94.2	0.77	0.84	1.43	–	0.74	− 0.5
Luxembourg	− 4.3 Aug	+ 2.1 Q2	na	na	103.3§	102.7	0.77	0.84	1.43	–	0.74	− 1.8
New Zealand	− 2.6 Sep	− 3.9 Q2	na	na	107.5	102.3	1.41	1.57	2.62	1.84	1.36	+ 2.9
Norway	+ 32.5 Oct	+ 31.7 Aug	na	na	99.9	98.2	6.23	6.85	11.6	8.11	5.98	+ 10.4
Portugal	− 16.9 Aug	− 11.2 Aug	na	na	93.6**	93.6	0.77	0.84	1.43	–	0.74	− 3.8

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, September average. ‡OECD forecast. **IMF, July average.

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About sponsorship

Exchange-rate forecasts

Nov 18th 2004
From The Economist print edition

Exchange-rate forecasts

Currency units per dollar

	Nov 16th	3-month	12-month
Euro area*	1.30	1.30	1.25
Japan	105	101	105
Australia	1.30	1.32	1.37
Britain†	1.85	1.84	1.74
Canada	1.19	1.20	1.25
Denmark	5.73	5.72	5.92
Sweden	6.90	6.94	7.20
Switzerland	1.18	1.19	1.18
China	8.28	8.06	7.60
Singapore	1.65	1.64	1.64
South Korea	1,092	1,100	1,150
Brazil	2.78	2.97	3.11
Mexico	11.4	11.5	11.9
Poland	3.28	3.21	3.20
Russia	28.7	28.6	28.2
South Africa	6.05	6.30	6.85

Source: J.P. Morgan Chase *$ per € †$ per £

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Overview

Nov 18th 2004
From The Economist print edition

The 12-month rate of consumer-price inflation in **China** fell to 4.3% in October from 5.2% in September. This mainly reflected a slower rise in food prices.

Mexico's GDP growth quickened to 4.4% in the year to the third quarter, its fastest growth for almost four years. Its 12-month rate of growth in industrial production also rose, to 5.5% in September.

Brazil's 12-month rate of consumer-price inflation edged up to 6.9% in October, but that was still well below its rate of 14% a year earlier. **Hungary's** inflation rate fell to 6.3% in October, its lowest this year.

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Current-account balances

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From The Economist print edition

As a proportion of GDP, Singapore's current-account surplus is one of the biggest in the world. Venezuela's surplus, boosted by its oil exports, is just over half as big. America's current-account deficit of 5.4% of GDP has spooked the foreign-exchange markets. That is marginally exceeded by the Czech Republic's deficit of 5.5% of GDP. But at 8.8% of GDP, Hungary is running the biggest current-account deficit of all among the larger emerging economies.

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Economy

Nov 18th 2004
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.1	Q3	+15.7	Oct	+ 4.3	Oct	+21.6	Oct	+45.9	2003	514.5	Sep
Hong Kong	+12.1	Q2	+ 1.1	Q2	+ 0.7	Sep	−13.8	Sep	+13.6	Q2	119.5	Oct
India	+ 7.4	Q2	+ 7.7	Sep	+ 4.8	Sep	−20.0	Sep	+11.0	Q2	115.7	Oct
Indonesia	+ 4.3	Q2	− 2.3	Aug	+ 6.2	Oct	+25.4	Sep	+ 3.9	Q2	33.6	Sep
Malaysia	+ 8.0	Q2	+ 9.8	Sep	+ 2.1	Oct	+21.1	Sep	+13.6	Q2	56.0	Sep
Philippines	+ 6.2	Q2	− 5.0	Aug	+ 7.1	Oct	− 1.4	Aug	+ 4.5	Jun	12.6	Oct
Singapore	+ 7.5	Q3	+11.8	Sep	+ 2.0	Sep	+15.6	Oct	+28.4	Q2	105.8	Oct
South Korea	+ 5.5	Q2	+ 9.3	Sep	+ 3.8	Oct	+29.1	Oct	+28.0	Sep	178.3	Oct
Taiwan	+ 7.7	Q2	+ 8.1	Sep	+ 2.4	Oct	+ 9.0	Oct	+25.8	Q2	235.0	Oct
Thailand	+ 6.3	Q2	+ 7.7	Sep	+ 3.5	Oct	+ 1.1	Sep	+ 6.7	Sep	43.7	Sep
Argentina	+ 7.0	Q2	+ 6.0	Sep	+ 5.6	Oct	+12.6	Sep	+ 4.6	Q2	18.6	Oct
Brazil	+ 5.7	Q2	+ 7.6	Sep	+ 6.9	Oct	+32.6	Oct	+ 9.8	Sep	49.5	Sep
Chile	+ 5.1	Q2	+12.0	Sep	+ 1.9	Oct	+ 7.9	Oct	+ 1.2	Q2	15.7	Oct
Colombia	+ 4.3	Q2	+ 8.9	Aug	+ 5.9	Oct	+ 0.4	Aug	− 1.6	Q2	12.1	Oct
Mexico	+ 4.4	Q3	+ 5.5	Sep	+ 5.4	Oct	− 4.9	Sep	− 6.7	Q2	62.2	Sep
Peru	+ 4.5	Sep	+ 4.0	Sep	+ 4.0	Oct	+ 2.2	Sep	− 0.7	Q2	11.4	Oct
Venezuela	+13.6	Q2	+27.6	Jul	+19.7	Oct	+20.3	Q2	+14.0	Q2	16.1	Aug
Egypt	+ 4.3	2004†	+ 2.3	2003†	+10.7	Aug‡	− 7.5	Q2	+ 3.7	Q2	13.2	Jul
Israel	+ 2.8	Q2	+12.5	Aug	+ 0.8	Oct	− 6.5	Oct	+ 0.1	Q2	26.1	Oct
South Africa	+ 2.5	Q2	+ 6.1	Sep	+ 1.3	Sep	− 1.1	Sep	− 3.5	Q2	11.3	Oct
Turkey	+13.4	Q2	+ 5.4	Sep	+ 9.9	Oct	−32.1	Sep	−14.0	Sep	34.7	Sep
Czech Republic	+ 4.1	Q2	+ 6.6	Sep	+ 3.5	Oct	− 1.8	Sep	− 6.2	Q2	27.1	Oct
Hungary	+ 4.0	Q2	+ 6.7	Sep	+ 6.3	Oct	− 3.0	Q2	− 8.4	Q2	14.5	Oct
Poland	+ 6.1	Q2	+ 9.3	Sep	+ 4.5	Oct	− 5.1	Aug	− 3.0	Aug	35.3	Sep
Russia	+ 7.4	Q2	+ 3.5	Oct	+11.5	Oct	+78.6	Sep	+44.6	Q3	103.6	Oct
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+ 5.9	Q2	+ 5.7	Sep	+ 4.5	Oct	− 2.5	Aug	− 1.5	Q2	1.5	Sep
Latvia	+ 7.7	Q2	+ 3.3	Sep	+ 7.2	Oct	− 1.5	Sep	− 1.5	Sep	1.7	Sep
Lithuania	+ 6.0	Q3	na		+ 3.3	Oct	− 3.1	Sep	− 1.8	Q2	3.3	Sep
Slovakia	+ 5.4	Q2	+ 5.0	Sep	+ 6.6	Oct	− 1.1	Sep	− 1.0	Aug	12.8	Sep
Slovenia	+ 4.6	Q2	+ 3.9	Sep	+ 3.3	Oct	− 1.0	Sep	− 0.8	Sep	7.8	Aug
Pakistan	+ 6.4	2004†	+27.0	Jun	+ 8.7	Oct	− 4.3	Oct	+ 0.8	Q3	10.8	Sep
Saudi Arabia	+ 7.2	2003	na		nil	Sep	+61.2	2003	+29.7	2003	22.3	Sep

*Excluding gold, except Singapore; IMF definition. †Year ending June. ‡New series, % change Jan-Aug annualised.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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Financial markets

Nov 18th 2004
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Nov 17th		Dec 31st 2003	
	Nov 17th	year ago	Nov 17th	% a year		one week	in local currency	in $ terms
China	8.28	8.28	15.4	2.75	1,423.7	+0.1	− 9.3	− 9.3
Hong Kong	7.77	7.76	14.4	0.25	13,825.0	+1.1	+ 9.9	+ 9.8
India	45.0	45.6	83.5	5.35	6,016.6	+0.7	+ 3.0	+ 4.5
Indonesia	9,003	8,474	16,709	7.49	934.0	+1.7	+ 35.0	+ 26.3
Malaysia	3.80	3.80	7.05	2.85	901.7	+2.2	+ 13.6	+ 13.6
Philippines	56.3	55.4	104.5	7.45	1,794.4	+0.9	+ 24.4	+ 22.6
Singapore	1.65	1.71	3.06	1.38	2,046.4	+1.2	+ 16.0	+ 19.6
South Korea	1,079	1,177	2,003	3.35	885.4	+2.9	+ 9.2	+ 20.6
Taiwan	32.6	34.0	60.4	1.25	6,028.7	+1.3	+ 2.3	+ 6.7
Thailand	40.2	39.9	74.5	2.15	644.2	+2.9	− 16.6	− 17.7
Argentina	2.94	2.87	5.46	5.19	1,262.1	−2.7	+ 17.7	+ 17.4
Brazil	2.76	2.94	5.12	16.74	24,169.8	+3.0	+ 8.7	+ 13.6
Chile	588	632	1,091	2.16	8,749.1	−0.2	+ 19.3	+ 20.2
Colombia	2,523	2,823	4,682	7.69	4,050.7	−1.0	+ 73.6	+ 91.3
Mexico	11.3	11.2	21.0	8.23	12,020.4	+1.9	+ 36.7	+ 35.5
Peru	3.31	3.48	6.14	3.05	3,604.6	+0.4	+ 48.0	+ 55.1
Venezuela	2,545§	1,598	4,723	13.34	29,756.5	+1.2	+ 34.0	+ 50.2
Egypt	6.24	6.15	11.59	10.56	22,521.6	+0.8	+ 93.5	+ 91.1
Israel	4.38	4.49	8.12	1.00	596.4	+4.5	+ 11.6	+ 12.1
South Africa	5.98	6.60	11.1	7.55	12,251.6	+0.4	+ 17.9	+ 31.7
Turkey	1,448,500	1,466,500	2,688,416	23.06	22,566.4	−0.2	+ 21.2	+ 17.5
Czech Republic	24.0	26.7	44.5	2.62	960.6	+1.2	+ 45.7	+ 56.1
Hungary	188	217	348	9.81	13,874.5	−2.2	+ 47.9	+ 63.5
Poland	3.26	3.88	6.05	6.85	25,277.9	−1.0	+ 21.4	+ 39.5
Russia	28.6	29.8	53.2	13.00	673.1‡	+1.2	+ 16.2	+ 18.7
EMF (MSCI)*	1.00	1.00	1.86	na	508.0	+3.3	+ 14.7	+ 14.7
EMBI+†	1.00	1.00	1.86	na	323.6	+1.5	+ 9.8	+ 9.8

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Floating exchange rate.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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